PUBLIC EMPLOYEE PENSION BENEFIT PLANS

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS

AND

SUBCOMMITTEE ON
LABOR-MANAGEMENT RELATIONS

OF THE

COMMITTEE ON
EDUCATION AND LABOR
HOUSE OF REPRESENTATIVES

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PUBLIC EMPLOYEE PENSION BENEFIT PLANS

TUESDAY, NOVEMBER 15, 1983

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS; AND SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS, COMMITTEE ON EDUCATION AND LABOR,

Washington, D.C.

The subcommittees met at 9:55 a.m., pursuant to notice, in room 2261, Rayburn House Office Building, Hon. William Clay (chairman of the Subcommittee on Labor-Management Relations) and Hon. Charles B. Rangel (chairman of the Subcommittee on Oversight) cochairmen, presiding.

[The press release announcing the hearing follows:]

[Press release of Tuesday, Nov. 1, 1983]

HON. CHARLES B. RANGEL, (D., N.Y.), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, AND HON. WILLIAM CLAY (D., MO.), CHAIRMAN, SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS, COMMITTEE ON EDUCATION AND LABOR, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCE A JOINT HEARING ON CERTAIN ISSUES REGARDING PUBLIC EMPLOYEE PENSION BENEFIT PLANS

The Honorable Charles B. Rangel (D., N.Y.), Chairman, Subcommittee on Oversight, Committee on Ways and Means, and the Honorable William Clay (D., Mo.), Chairman, Subcommittee on Labor-Management Relations of the Committee on Education and Labor, announced today that the Subcommittees will hold a joint hearing on certain issues regarding public employee pension benefit plans (governmental plans). The hearing will be held on Tuesday, November 15, 1983, beginning at 9:30 a.m. in Room 2261, Rayburn House Office Building.

The Subcommittees will receive information from invited witnesses on the growth, scope and financial status of governmental plans and whether additional federal disclosure, reporting, or fiduciary standards for such plans are appropriate.

The Subcommittees will also receive information concerning provisions of the Internal Revenue Code which relate to governmental plans. Under present law, a pension plan, including a governmental plan, is tax qualified if it meets certain requirements of the Internal Revenue Code. Tax qualified plans and employees covered by them receive favorable treatment under the code.

For those who wish to file a written statement for the printed record of the hearing, six copies are required and may be submitted by the close of business Monday, November 28, 1983, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515. An additional supply of statements for the printed record may be furnished for distribution to the press and public if supplied to the Committee office prior to the hearing.

Mr. CLAY. The committee will come to order.

I understand that Mr. Rangel is on his way, but we are going to start without him this morning.

The subcommittee begins this morning what has become over the years a familiar ritual: taking testimony on issues relating to State and local pension plans.

In every Congress since the enactment of the Employee Retirement Income Security Act of 1974 [ERISA], a bipartisan bill has been introduced to establish minimum reporting, disclosure and fiduciary standards for State and local pension plans.

Originally the bills bore the acronym "PERISA," but last year the name was changed to "PEPPRA"—the Public Employee Pension Plan Reporting and Accountability Act—to reflect the true nature of our proposal.

Too often people assumed, incorrectly, I might add, that the bill was simply all of ERISA applied to public plans.

Instead, the proposals were far more limited in scope than ERISA and were far less burdensome or costly to pension plans. Although no bill has yet been introduced this Congress, we anticipate introduction soon.

In every Congress, our subcommittee has dutifully held hearings in which the proponents of the legislation argue that Federal legislation is essential to assure that plan participants and taxpayers get complete, comprehensible, and current information about their plans and that those plans are well managed and the assets are invested prudently.

On the other hand, opponents of the legislation argue that Federal legislation is unnecessary and undesirable.

Today's hearing, however, promises to be quite different from those held in the past.

First, we welcome the joint participation of the members of the Oversight Subcommittee of the Committee on Ways and Means, led by its distinguished chairman, Charlie Rangel of New York.

And second, we welcome the participation of the Internal Revenue Service in our oversight activities.

Many State and local officials seem unaware that their plans are already subject to Federal regulation through the Internal Revenue Code. We look forward to hearing about the Service's efforts to enforce the current Federal requirements.

We welcome all the witnesses today and look forward to an informative and interesting morning.

Are there any other opening statements?

Mr. Bartlett.

Mr. BARTLETT. Mr. Chairman, just briefly.

I join you in welcoming everyone here to the beginning of these hearings.

I would comment I have a number of constituents here from the great State of Texas, some of whom are from the great Third Congressional District of Dallas, others who live in the suburbs of the southern portion of the city of Dallas and the city of Austin.

I am looking forward to the hearing this morning and the information that will be provided. It seems to me that as we begin the hearings, the burden of proof for the need for Federal legislation should be on the proponents of that Federal legislation.

No doubt there are problems with individual systems around the country. It seems to me that most pension systems, public employee pension systems, are sound and if not sound, many systems have taken substantial actions to provide for their own solvency.

Generally, while I look forward to the information provided, I am generally skeptical of the need for additional Federal legislation, but I do look forward to the information to be provided this morning.

Thank you, Chairman Clay.

Mr. CLAY. Thank you.

Mr. Martinez.

Mr. MARTINEZ. No questions.

Mr. CLAY. Our first witness this morning is the Honorable Kiliaen Townsend, State representative, State of Georgia, on behalf of National Conference of State Legislatures.

Mr. Townsend, welcome to the committee.

Your entire written statement will be included in the record without objection. You may proceed as you desire.

STATEMENT OF HON. KILIAEN TOWNSEND, STATE REPRESENTATIVE, STATE OF GEORGIA, ON BEHALF OF NATIONAL CONFERENCE OF STATE LEGISLATURES

Mr. TOWNSEND. First of all, my name is Kil Townsend. I chair the Pension Committee of the National Conference of the State Legislatures.

I must admit 10 or 15 years ago when I first got into this unglamorous, unsexy subject as a legislator in Georgia I had to come up with something and this seemed to be one area nobody seemed to want to fool with. I realize the needs and neglect in this area.

Georgia was a big offender. I am here to tell you those days are over. We have had 10 or 12 years of constant effort through the State legislators meeting with the NCSL. We have two members from each State on our pension committee which has now been made a permanent committee of NCSL.

We have had five members such as Representative John Bragg from Tennessee, Jim Clark, senator from Maryland who have served as chairmen of our pension committee and also on President Carter's Presidential Commission.

I think I can sit here and say without reservation that there has been progress made in every State in the country. Admittedly, that progress has varied. Some States need more reform, some States need an awful lot.

Reform in some cases may require more money which is always a problem in any State budget. Most States now have pension commissions or legislative committees to see that the system is properly funded, that they are actuarially sound, reports are made every so often to the legislature and, of course, they have gotten onto the municipal and county systems and the multitude of systems any State has—and these cause problems also.

In addition to the usual State teacher and State employee systems, there are all sorts of municipalities that have systems, some of which are partially or totally unfunded. States are passing laws every year that affect systems. We see progress in this area, however, and amazing progress in the last few years, that is, since 1978 or 1979.

A lot of the reports you will have are based on things of 4 or 5 years ago. I dare say you will see another four or five States initiate reform measures during the next regular sessions. We in Georgia have taken these measures in the last year.

First of all, in Georgia you can't pass a retirement bill now in 1 year. You have to wait a second year before it can be acted on. You also have to appropriate money for the additional cost or it is void at the end of that session.

If the municipality does not comply with these new requirements, the State can withhold funds from the city or county. Numerous States, New York, Massachusetts, California, have all done really positive things in this direction.

The problem is, in my opinion, that you are faced with the same problems in the Federal pension systems and, in fact, you have the worst problem of all and you are the principal beneficiaries of one of these systems.

The minute you change the age level at which people retire or you make disability requirements more lenient, and particularly when you add COLA's you will upset an otherwise sound system. A COLA particularly is the most devastating thing that has hit both the Federal Government and the State government as to the soundness of the pension system.

Unlike the Federal Government, we in the States have limited COLA's after a few bad experiences, Maryland is one in particular where they figured out with a full cost-of-living provision by the year 2000 it would take 50 percent of all the Maryland operating budget to fund the pension system.

So the State of Maryland reversed itself and restricted COLA's to 3 percent. Most States now have a 3- or 4-percent cap on any COLA.

Therefore unlike the problem you have with military and the Federal civil service, we won't be doubling pensions in a matter of 5 or 6 or 7 years, depending on how fast inflation is compounded.

Whereas the Federal Government is faced with over a trillion dollar unfunded liability right now and is going up to $2 trillion at the rate of $4 billion a week, just the Federal pension systems, just about every State pension is being funded now virtually on a 40-year basis.

States are changing the liberal age mistake on new retirement systems. In my opinion military credits are very costly and, unlike the Federal system, some States are cutting out military credits. To make the system sound, to protect the very public employees we are worrying about, we have to make it financially sound, and that is being done.

In my opinion there are simply too many systems in the States to effectively regulate them from Washington. Some States have over 1,000 pension systems. In Georgia we have several hundred. If we send in a piece of paper simply once a year from 10,000 to 15,000 systems, it will simply mean a big warehouse full of paper.

NCSL has encouraged its members to press for pension reform in their States. I think you will find that we are doing the very things that public employees feel need to be done to bring about reform in their system. In my opinion, we also do have to represent the other 110 million taxpayers who do not belong in these public systems but have to pay the bill.

I think the average State legislator now realizes he has been passing on the cost to future legislatures. Much of the regulations that you can think of or would like to have, such as reporting and minimum requirements, are now being done at the State level where it should be done and they are the ones that are financially responsible for the taxes to make up any of these deficits.

State legislators are the ones who are now concerned, which I admit wasn't true years ago. I think we have something here that is past its time as far as being necessary and something that would really accomplish nothing at the State level except more paperwork, more requirements, more Federal intervention, more bureaucracy.

This cannot be handled out of somebody's small office. This kind of reporting will be overwhelming. We are suggesting as people on the firing line at the State level that we State legislators are willing and are going to undertake this task that you want done one way or another, we would like to think that you will continue to respect our wishes in this matter.

We are not trying to be a roadblock and be difficult. We feel we are being practical. We are beginning to get the job done which certainly needs to be done.

If you have any questions, I will be glad to answer them if I can.

[The statement of Mr. Townsend follows:]

STATEMENT OF REPRESENTATIVE KILIAEN TOWNSEND, STATE LEGISLATOR, STATE OF GEORGIA, ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES

Mr. Chairman and Members of the Committee. My name is Kil Townsend, State Representative from the 24th District, State of Georgia. I appear before you today as Chairman of the National Conference of State Legislatures' (NCSL) Committee on Pensions.

The National Conference of State Legislatures is the official Bi-partisan representative of the nation's 7,500 state legislators. NCSL seeks to foster interstate cooperation and to assure a strong voice for states in the Federal decision making process.

On behalf of NCSL, I appreciate the opportunity to appear before you today and share our concerns and experiences regarding public employee retirement systems.

The NCSL Pensions Committee, which I chair, has been the focal point for activities of the legislatures aimed at improving pension plans in the states. As a committee we have urged state legislatures to establish special joint pension committees to review and make recommendations for reforming their individual retirement systems. As legislators, the 70 members of the NCSL Pensions Committee have been in the forefront of recommending changes in their state systems and are responsible for many of the significant improvements in state pension systems over the last decade.

State legislatures share the goal of this committee of insuring adequate security for state and local employees in their retirement years. To achieve this goal, we have undertaken significant steps to rectify the shortcoming of our employee retirement plans and have urged all states to work to improve the funding and management of state pension plans.

Despite the similarity of purpose between state legislatures and the Congress, we must disagree with the methods proposed in earlier PERISA legislation and more recently in PEPPRA legislation. It is our belief that state government is the appropriate level to deal with employer-employee relations in the area of government employee compensation.

Federal legislation, designed to regulate public employee retirement plans, represents an intrusion of the Federal Government into affairs that are without question within the province of state government. Federal regulation in this area is not only inappropriate but also impinges on the division of powers set forth in the Constitution.

An Advisory Commission on Intergovernmental Relations (ACIR) study evaluated the underlying question of which level of government should control public pension systems. Based on this study, entitled "State and Local Pension Systems—Federal

Regulatory Issues", the Commission concluded that state and local retirement systems should be exempt from ERISA type requirements. The study expressed opposition to all forms of federal regulation of state and local plans. Thus in specifically focusing on Federalism as a major issue, ACIR decided the question in favor of state control.

It is our concern that additional federal legislation may impose disclosure, reporting and fiduciary regulations on state and local pension plans and give substantial regulatory power to a federal agency. The legislation would add yet another level of bureaucracy and administrative paperwork and increase costs at a time when concerted strides have been made by the Administration and Congress to reduce the regulatory burden on state government and all our citizens.

In voicing our concerns, we do not intend to minimize the problems which still are present in some state employee retirement plans. State officials have long recognized the need for reform of state and local pension systems. The fact that NCSL created a pensions committee is a clear reflection of the recognition of the need for state improvement in the pension area. In conjunction with the establishment of NCSL, a Pensions Task Force was created to respond to interests in this subject among state legislators. The work of the Task Force and the efforts of the many state legislators who participated were instrumental in publicizing the need for reform of state plans. In more than half of the states, the Task Force held seminars and provided technical assistance for state legislators. In 1980, the Task Force was elevated to one of the ten standing State-Federal Committees of NCSL. The Committee has continued the work of the Task Force and formally endorsed the principles of pension reform which are attached to this statement.

In recognition of the need for pension reform, many states have adopted legislation or implemented procedures to initiate the process. In 1975, only four state legislatures had standing legislative committees which dealt with pensions. As recently as 1978, only a dozen states had pension commissions. As Appendix A shows, more than thirty states now have pension commissions, or legislative pension committees. These pension bodies serve as a source of expertise on state pension policy and are an important element in providing information necessary to implement reform strategies.

States have adopted a variety of approaches in improving their state and local pension plans. Minnesota, Montana, New Jersey and Washington have created state administered plans for local governments and require municipalties to cease creating new plans. Wisconsin has joined the states of Hawaii and South Dakota in implementing a single consolidated plan for all public employees. The state of Florida requires all local governments to prepare actuarial valuations every three years and to submit them to the state for review. These valuations must include a 40 year amortization plan for unfunded liabilities which are the basis for contributions to the local plan. Failure to comply with these conditions result in a declaration of financial emergency and temporary assumption of local budget authority by the state. This approach answers the soundness of local pension plans and guarantees the pensions of public employees. In 1982, Florida's annual report on local retirement systems noted that overall the program is working well and local governments have been cooperative.

The state of Texas established in 1979, an independent Pensions Review Board as permanent oversight pensions body. The authorizing legislation required that all pension legislation have an actuarial analysis showing present and future cost obligation. All public retirement systems must register with the Board and submit semiannual reports which contain summaries of the benefits available, the current financial status, and the actuarial conditions of the system. All members in the system must be provided with a summary of plan benefits, a summary of changes in acts affecting contributions, benefits or eligibility, and annual statements of the amount of a member's accumulated contribution.

While there is a diversity of state experiences, some trends have emerged. As shown in Appendix B, state administered systems cover about 90 percent of all state and local pension participants. According to surveys NCSL conducted in cooperation with the Advisory Commission on Intergovernmental Relations in 1979, these systems have extensive reporting and disclosure requirements. The large majority of them require regular actuarial valuations, audit reports to states and employees, and fiscal notes. Some states require this reporting by statute, others do it by administrative regulation, and still others by policy or custom.

Our pension surveys showed a wide variety or approaches to pension reform. All of these approaches represent improvement in current plans and progress toward a common goal of ensuring protection of pension benefits while not placing an unnecessary burden on pension costs on current and future taxpayers.

States have a long and successful record of improvement in state and local retirement plans. In light of the continued activity in the states and the long list of accomplishments, it is our belief that the level of government best suited to control public employee pension plans are the states and local governments. We urge you to continue the work which was initiated by the Congress to reduce the regulatory burden on state government rather than to impose a new and unnecessary regulatory structure.

Once, again, I'd like to thank you for the opportunity of appearing today and assure you of NCSL's interest in maintaining a dialogue with you in any future deliberations regarding public employee retirement systems.

NCSL PUBLIC PENSION REFORM PRINCIPLES

The National Conference of State Legislatures encourages state legislatures to give high priority to the study of public retirement systems and to take the following corrective actions:

1. Create permanent pension review committees, with sufficient staff and actuarial assistance to analyze pension problems and recommend legislative changes;
2. Reexamine current benefit provisions and revise to eliminate abuses;
3. To avoid duplication of benefits in those state plans having Social Security, integrate state and local pension plans with the federal Social Security System;
4. Discourage the early retirement of employees on unreduced pensions, based on unsound fiscal policy;
5. Provide follow-up screenings of disabled retirees to determine whether individuals are still disabled;
6. Given the cost implications of inflation, "cap" automatic cost-of-living adjustments of retirees;
7. Encourage "portability" of plan membership for persons who shift jobs within the state and its political subdivisions;
8. In order to avoid conflicting objectives, do not amend or establish pension plans through collective bargaining;
9. Provide adequate funding of established benefit costs and front-end funding of amended benefit costs;
10. Establish flexible guidelines for the management of investments and determining fiduciary responsibilities, especially those related to advisors, brokers and custodians with the ultimate objective of instituting the prudent person rule;
11. Provide uniform actuarial reports, financial statements and management summaries to state legislature on an annual basis;
12. Require regular financial audits be performed by an independent auditor;
13. Regular actuarial valuations should be conducted using accepted assumptions;
14. Require fiscal impact statements (fiscal notes), when establishing or amending pension plan benefit provisions;
15. To achieve uniformity of benefits, support state regulation and/or public pension plan consolidation of state and local retirement systems; and
16. Prohibit substantive changes in pension benefits or contribution by a body other than the state legislatures unless guidelines have been established to govern the actions of such a non-legislative entity.

Appendix A

STATES WITH PENSIONS COMMISSIONS AND/OR LEGISLATIVE PENSIONS COMMITTEES

Arkansas, California, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky, Louisiana, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, West Virginia, and Wisconsin.

Appendix B

Percent of total State-local employees covered by State administered systems

Alabama	89	Connecticut	81
Alaska	98	Delaware	93
Arizona	92	Florida	90
Arkansas	97	Georgia	84
California	78	Hawaii	100
Colorado	78	Idaho	100

Percent of total State-local employees covered by State administered systems—Continued

Illinois	74	New York	73
Indiana	87	North Carolina	99
Iowa	96	North Dakota	96
Kansas	95	Ohio	99
Kentucky	96	Oklahoma	89
Louisiana	90	Oregon	95
Maine	100	Pennsylvania	78
Maryland	81	Rhode Island	87
Massachusetts	57	South Carolina	99
Michigan	84	South Dakota	97
Minnesota	91	Tennessee	83
Mississippi	91	Texas	92
Missouri	99	Utah	100
Montana	99	Vermont	96
Nebraska	70	Virginia	85
Nevada	100	Washington	94
New Hampshire	99	West Virginia	98
New Jersey	99	Wisconsin	90
New Mexico	100	Wyoming	100

Mr. **Clay**. Thank you. Before we begin to ask questions, first of all, the Chair would like to recognize the newest Member of Congress and welcome him to the committee, Congressman Charles Hayes from the State of Illinois.

Mr. **Hayes**. Glad to be aboard.

Mr. **Clay**. We will also at this point recognize the cochairman of this joint hearing, Congressman Charles Rangel of New York.

Mr. **Rangel**. I apologize for being late.

The Subcommittee on Oversight of the Ways and Means Committee is glad to respond to the request by our colleague Bill Clay, to review some of the issues concerning public employee pension plans. This is the first time that the Ways and Means Committee has taken a look at some of the questions that have been raised.

While we are not here to legislate, it is abundantly clear that these are important questions concerning the tax treatment of public plans. Mr. Clay's subcommittee has done a great deal of work on other issues such as disclosure requirements and appropriate fiduciary standards. I understand that legislation will be proposed on these issues and we look forward to reviewing all of these questions involved.

[A prepared opening statement of Mr. Rangel follows:]

Opening Statement of Hon. Charles B. Rangel, Chairman, Subcommittee on Oversight, Committee on Ways and Means

I am pleased to join today with Chairman Clay and the other members of the Subcommittee on Labor-Management Relations to begin an examination of certain issues regarding public employee pension plans.

Governmental plans are a major source of future retirement income for more than 11 million state and local workers and their dependents. With assets of $245 billion, public employee pension plans pay out more than $13 billion in benefits annually.

In 1974, the Congress enacted the Employee Retirement Income Security Act (ERISA) to safeguard the interests of pension plan participants and beneficiaries. In general, governmental plans were excluded from major provisions of ERISA. Since

1974, there has been continuing debate over the need for Federal standards. A congressional study, mandated by ERISA, has been issued and legislation introduced but not enacted. The purpose of the hearing today, however, is not to consider particular legislative proposals, but rather to raise essential issues and questions related to governmental plans. For example, we are interested in receiving information on their financial status and on provisions of the internal revenue code which relate to public plans.

The Committee on Ways and Means is particularly interested in the tax treatment of governmental plans. Under current law, "qualified" pension plans, including governmental plans, receive the tax preference of deferral for employer contributions and for earnings from pension funds until such funds are distributed to retirees.

In general, for tax qualification, governmental pension benefits, contributions, and coverage must not discriminate in favor of highly paid officials and employees. In addition, trust investments and income must be for the exclusive benefit of employees and beneficiaries. As a practical matter, however, these requirements have not been enforced by the Internal Revenue Service. We are interested in the appropriateness and consequences of applying these requirements to public plans.

While the Committee on Ways and Means has not previously reviewed public employee pension plans, we share jurisdiction with the Committee on Education and Labor. Thus, the Subcommittee on Oversight is pleased to join in this examination of the fundamental issues involved.

Mr. CLAY. Thank you.

Representative Townsend, the bill we reported out in the Education and Labor Committee last year is very different from the first bill introduced in 1975. Yet your testimony is virtually identical to the testimony given by other NCSL representatives many times in the past.

While in some cases consistency is a virtue, I really suspect that the reason your testimony never varies, regardless of what the bill looks like, is basically that you are just opposed to a bill.

Is that correct?

Mr. TOWNSEND. No, Mr. Congressman.

As I say, I agree that 7 or 8 years ago, even 4 years ago, perhaps, a lot of States were dragging their heels. I am updating that testimony as the chairman.

I was on the NCSL pension task force for 10 years. I am the first to admit when we started out we could meet in a telephone booth with those who were interested, and we did many times meet over breakfast, four or five of us.

Now we have good attendance from different States. They each report every year as to what his or her State has done. We go all around the room to each member. It is just amazing as I see each year how many States are doing something.

I think I can honestly say that I don't know of a State which has done nothing. Many States have done drastic things just like Georgia. Georgia has started a whole new retirement system, giving plan members an opportunity to switch over if they want to in order to make the new system sound, eliminate the military credit and all the things that we really can't afford to give.

Mr. CLAY. You stated in your verbal testimony a few minutes ago that you could state without fear of contradiction that all States were making significant progress.

Now you say that none of them are dragging their heels now as they did originally in 1975. I note you have listed the States with pension commissions and/or legislative pension committees. You listed Michigan as one of those States.

Is it true that Michigan's commission is neither funded nor staffed?

Mr. TOWNSEND. I think there has been a political problem in Michigan. Actually, the Michigan pensions committee, it is not in being yet. I don't know about the history of what happened, but it was a political problem.

So, you may be correct, that the pensions committee has yet to be implemented in Michigan.

Mr. CLAY. It will take them 4 years to resolve the political problems and not have to drag their heels.

Mr. TOWNSEND. Congressman, in my opinion it is like Congress, it is hard to get anything done in this area because it is not interesting. You and I know it is passed on to the next legislature.

The money is owed and not collected, it is a sort of hidden budget item. It is hard to get people to react to it. It has taken us years in Georgia to get significant legislation.

I think most States are rolling along now and doing something and shouldn't require any more prodding. At the local level if plans won't appropriate money or won't insure the benefits, I doubt if there is anything that the Federal Government can do except set up a lot of regulations and maybe sue the State.

It is a very expensive business. These have been bad years the last few years, yet we went ahead and put $30 million more a year in the State employment system.

The reason that some States were in the dark, is that they were getting reports that the plans were sound. Georgia got the same thing. When you have in-house actuaries, you sort of get whatever one wants to hear.

We went outside and hired outside actuaries to show the State employee system was $1.2 billion unfunded. Nobody believed that.

We hired a second outside actuary and a third. We now know it is $1.2 billion unfunded when we thought there was none. So, now we are putting $30 million a year into it to fund it over a 40-year period.

This is the kind of thing you have to do in each State. In my opinion there is nothing that the Federal Government can do about this. I don't think the Federal Government is going to be helping the State employees or taxpayers, you are not helping anybody if you simply ask us to report to Washington and withhold highway funds or however you could enforce it.

We in Georgia can withhold funds from municipalities if they don't agree to do what we want them to do. We are in a position to do that. I don't see how this kind of bill can do the very things that need to be done, namely, to make States or local governments contribute to the fund if there is not enough in the kitty.

Mr. CLAY. When you compare the inability of Michigan to resolve its problem in 4 years with our inability here in the Congress to resolve problems, I will say to you without fear of contradiction that if it took us 4 years to resolve the problem, we would be accused of foot-dragging or heel-dragging or however you characterize the progress of the States.

Let me ask you one other thing.

In your testimony you attempted to equate this bill with providing certain powers to the Government to come into your States and impose on you increases in benefits. You talked about the COLA and what that would do to the plans and reducing the age of retirement, et cetera.

I don't know of any bill which has been introduced that would have required that.

Mr. TOWNSEND. That was not my intention.

I meant those are the problems that States are faced with as the Federal Government is faced with similar problems in its pension systems. These are the problems that need to be addressed to protect the funds for the employees, to see that the funds are adequate to pay the benefits.

I did not mean you would do that.

When you mentioned your 4-year solution, Congressman, in my opinion you have not solved your problem in the last hundred years. You are now faced with a trillion and a half dollars unfunded and nobody is doing anything about the COLA, the benefits, military, congressional pensions or early retirement.

In my opinion that is why the Federal Government is going down the tube $4 billion a week right now. Your funds are slipping that much.

We in the States are putting in additional funds where we are slipping. You may not want to hear this, but the Federal Government has a problem that is greater than the national debt and its pensions have a bigger yearly deficit than the national debt itself.

The States really are doing their part. If you total up the States unfunded liabilities it is not a trillion and a half like the Federal Government, it is in the several hundred billion dollar area.

Mr. CLAY. Let me say to the gentleman that the only reason that you are able to quote those figures is because we already are in compliance with what we are asking the States to come into compliance with. The Federal plans do report and disclose.

That is simply all we are asking you so that we can quote to you what your liabilities are, what your investment plans are, whether they are good or not.

I think the people who contribute money to your plan have a right to know what you are doing with that money. It is just as simple as that.

You can quote the figures for the Federal retirement pension plan, but the only reason you can is because we do report and we do disclose. If you had to do the same thing, then I could sit here and quote your unfunded liabilities also.

Mr. TOWNSEND. My point is, Congressman, that the thrust of what we are trying to do is protect the public employees.

Mr. CLAY. From knowing how you invest their money. That is what you are trying to protect public employees from.

You come here and oppose a simple bill that requires disclosure and reporting. I know what you are trying to protect the public employees from, from knowing how you invest their money. It is as simple as that.

Mr. TOWNSEND. I thought the point of the bill was the reporting which, as you say——

Mr. CLAY. And disclosure.

Mr. TOWNSEND. And disclosure.

My point is that what the State employees and Federal need to do—the State can't print money, they have to know they are going to get paid and the system is sound. They have to know that the State is willing to do something about it and are doing something about it.

Mr. CLAY. Your argument, sir, is that they have to know that the system is sound, yet you don't tell them what the system is. You don't report, you don't disclose.

How can they make a determination that the system is sound when you have all the information?

Mr. TOWNSEND. Not in Georgia, not in most States now, Congressman. You are right, they probably used to.

Mr. CLAY. If they are in compliance with what we are suggesting, I don't know why you oppose it.

Mr. TOWNSEND. Why would we need it if they are already complying? It works both ways.

The amount of paperwork and the bureaucracy is the issue now. What I am stressing is that what we need to do and are doing would be to stop giving away money we don't have, stop giving COLA's, stop giving lower age reductions, stop big disability benefits. We have to stop that.

That is the problem.

Mr. CLAY. This bill does not deal with that, sir. That is the point I am trying to make.

Mr. TOWNSEND. My point is that we don't need a bill because those are the areas where we feel we are improving.

Mr. CLAY. Thank you.

Mr. Rangel.

Mr. RANGEL. Thank you, Chairman Clay.

Representative Townsend, you don't have any problem with the Federal Government having some oversight responsibility as relates to the tax treatment that is given to investments by public employers, do you?

In other words, there are certain Federal standards that exist in the law which have to be complied with without any additional legislation.

Mr. TOWNSEND. I agree. The IRS is doing that and can do that without this bill.

Mr. RANGEL. Earlier you spoke about the intrusion of the Federal Government into the affairs of the States if we enacted some additional reporting and make certain that the funds are being used for the use and benefit of the employees.

It would seem to me this would be something that local and State governments would welcome, not only in order to continue to enjoy the support of the employees, but also to make certain that they are working within the spirit and framework of the Internal Revenue Code.

Mr. TOWNSEND. I agree we don't need this bill. The IRS can set up regulations as to what qualifies.

Mr. RANGEL. I commend the job that your association has done in terms of improving public plan reporting. Would you agree that the joint task force that has the responsibility to report to Congress concluded that many of these pension plans were deficient?

Mr. **Townsend**. That is what I am saying, you need to update it. Every year you would have to check the legislation. Just like ours, we just passed our bill, in that all public pension systems have to make full disclosure, and report regularly.

It is an improvement. I think you will find this is going on almost every year that the legislatures are meeting. Right now I think you will find the others too, are catching up.

Mr. **Rangel**. It seems odd to me to see my colleagues in Government, even though it is not the Federal Government, resisting what I thought the public officials should be rather proud of, and that is to disclose what they are doing with other people's money.

Mr. **Townsend**. I agree, Congressman, and we are making those disclosures in almost every case now. I admit you can dig up a little State that is not doing anything.

Mr. **Rangel**. I am not making myself as clear as I want. But in the Congress we are subject to a lot of criticism as relates to our own conduct.

We then move forward in order to protect ourselves and create regulations and committees for ethical conduct in order to make certain that we not only investigate possible wrong doing, but that we also address the perception of wrongful conduct. It just appears to me that employees just want to know that the people who have the responsibility and the fiduciary responsibility are protecting their pension plans for future years when they retire and as a former State legislator, I would think that your association would say that while it is not "necessary", we would welcome public disclosure of what we are doing with money that doesn't belong to us, how we are investing it, and making certain that the investments are prudent and it is made primarily for the employees and not for other interests that public officials may have.

I don't see why you are resisting this. Even though we don't intend to act on legislation at this time, I assume that your posture is not one that all State legislatures support.

Mr. **Townsend**. I will say this. You can get a list of four or five who don't comply, disclose, et cetera. We have explained it to their legislators on the NCSL. They have gone home and seen that these things are done.

Virtually all of them are doing some kind of improved reporting. It may not be as often as you might want and it might not be accurate. It has been our experience you can't get good figures.

Mr. **Rangel**. Besides the argument of Federal intrusion in the affairs of local and State government, you don't see where we would be doing anything more than duplicating what you have said is already being done by the local and State officials?

Mr. **Townsend**. That is true and getting just a warehouse of paper. It is a tremendous job, there are so many systems.

Mr. **Rangel**. With credibility that is being lost in all forms of government, local and State as well as Federal, it would seem to me that a little extra paperwork and giving employees the feeling that their moneys are properly being invested and allowing us in the Congress to know that we are giving tax exemptions to pension plans that are indeed qualified would be supported. I am certain this is not something that we will get public resistance on from State legislatures or a question on election time.

Mr. TOWNSEND. Just mentioning elections, our State is in a tremendous turmoil about pensions. As you may know, you can retire at age 45 on full salary with involuntary separation from Government. It has had a lot of publicity.

What the bone of contention is is the cost. The taxpayer wants to know that we are not granting too big benefits and if we grant them, we will put the money in year to year.

I think one thing, you start putting the money in or cutting benefits or reporting every year, that's what the problem is. It is like your reporting a problem to us, if we don't do anything about it, what good is it to the State or local employees.

I am saying the State is getting actual experience and doing something about it. I am talking about putting money in and stop granting ridiculous benefits which is the problem the Federal Government is faced with.

You may require better reporting but not doing anything about cost containment. We are doing something about solving the problems of pensions funding.

Mr. RANGEL. It seems to me that if we are concerned about the taxpayers, as we have to be, you should allow them to know that these plans are not going to go belly up and the State legislatures will not be coming to them for funds to bail out a system.

If you can do it up front for them, I am certain they will understand, by election time they will monitor these obscene benefits and at the same time know that the States are fulfilling their responsibility to their fellow citizens who happen to be Government employees.

Mr. TOWNSEND. Which make up only about 10 percent of the taxpayers.

Mr. RANGEL. It does not make them any less citizens.

Mr. TOWNSEND. No. I am speaking for the other 90 percent who are taxpayers, and we need these systems to be made sound so there will not be any surprises.

I don't know of any State that knows they are in terrible shape that is not doing something. Massachusetts and California are in terrible shape but are starting to fund.

Mr. RANGEL. Thank you.

Mr. CLAY. Mr. Erlenborn.

Mr. ERLENBORN. Thank you, Mr. Chairman.

First of all, let me apologize for running in and out. I have had to do this because of the other meetings I have to attend.

I did want to make the observation in fact that in 1974 when we were considering ERISA, I offered an amendment to make it applicable to public pension plans as well as the private sector.

The amendment passed, by the way, in committee. It held for 1 day and then the very next day a motion to reconsider was carried and that amendment was taken out of the bill.

At that time I recognized the need for Federal regulation of public sector pension plans. I also realized at that time it wasn't just as simple as making ERISA with all its provisions applicable to the public sector, but still I made the point that I thought was important.

Subsequent to the passage of ERISA, with the help of staff, I did draft what we called PERISA, the Public Employee Retirement Income Security Act, which was introduced in several Congresses earlier.

I was joined in cosponsoring that by our former colleague, Phil Burton, in the past Congress and I am happy to see that there is a move toward bipartisan support of such a measure in this Congress.

I want to thank you, Mr. Chairmen, both Mr. Rangel and Mr. Clay, for scheduling these hearings that I hope indicate that this Congress may see the passage of legislation to impose reasonable regulations on the States.

I am going to have to run to another committee, so I am not going to ask any questions.

Let me say that the outline of the legislation we have had in the past, if passed would be a catalyst to get the States to do what they should be doing, rather than to oppose Federal regulations, to put a regulatory scheme for reporting and disclosure and fiduciary standards into place.

The reporting and disclosure part would be applicable to the States only if they didn't have their own reporting and disclosure mechanism in State law.

We would also make the Federal law effective sometime in the future, 4 or 5 years in the future, to give the States an opportunity to put into place their own regulatory scheme.

They might never need to have the application of Federal law. Some forget, but it is true, we have Federal regulation of insurance in law, but not in practice, because the States were able to provide their own regulatory process and every State has done so. I see this legislation working in much the same manner.

Mr. Chairman, the studies done by the pension task forces in the past which have been updated in the private sector show a very desperate need for this type of legislation.

Again, I want to thank both of you for your interest in this.

Mr. CLAY. Thank you.

I want the record to note that the gentleman has to run to another committee meeting. So, I say to him, "Run, John, run."

Mr. Martinez.

Mr. MARTINEZ. I have no questions, Mr. Chairman.

Mr. CLAY. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman.

I gather that you want to leave jurisdiction basically to the States and local government; is that right?

Mr. TOWNSEND. Yes, because what we have done since Mr. Erlenborn's original thrust 10 years ago—I am the first to admit we probably needed some prodding at that time. I think we have had sufficient prodding.

Mr. DUNCAN. What problems do your State pension systems now face that motivates all this interest?

Mr. TOWNSEND. Just money. The problem is money, if that is what you mean. It is the same problem you have on Federal pensions.

Mr. DUNCAN. We probably have a worse problem than you.

Mr. TOWNSEND. Yes, far worse, you are a trillion and a half unfunded. You have a real problem because you are only dealing with 7 million people and have a trillion and a half liability whereas social security has 110 million people and has only a 6 trillion liability.

Your situation is really a disaster.

Mr. DUNCAN. We are not in a good position to tell you how to run your business.

Mr. TOWNSEND. The worst thing is this COLA business. We hope you will consider a COLA cap in not only social security, but all pension systems.

Congressmen are retiring at the age of 45 or 50. In civil service you have 70,000 civil service employees getting over $50,000 retirement right now. These pensions will be $100,000 in 10 years or less.

The COLA thing is bleeding you to death. I am saying get hold of these problems. I think you will find that we are.

It is money. It is limiting the benefits. We have been among the worst ones.

Mr. DUNCAN. Thank you very much. Thank you, Mr. Chairman.

Mr. CLAY. Mr. Hayes.

Mr. HAYES. I am just learning and listening. I am vitally interested in this whole area. I am going to read your statement to become more familiar with it as time goes on.

I gather that you are opposed to Federal legislation.

Mr. TOWNSEND. I am saying that we would have welcomed your help 10 or 12 years ago in a sense because we couldn't get the States off the stick. But I think we are moving now, I know ours is, and some of the others are.

You have been very helpful. But I don't think we need any bill at this point.

The idea of just having regulations on hand will do some good in case it is needed is a new wrinkle, but I am not sure we need that.

Mr. HAYES. How do you propose to protect the investments of the individuals?

Mr. TOWNSEND. Where they put the money?

Mr. HAYES. That is right.

Mr. TOWNSEND. Most States are putting in a prudent rule theory. That is not really a help. Is it prudent to buy Chase Manhattan stock and Bank of America when they are making loans to South America?

The prudent rule is a hindsight kind of thing. It is hard to criticize. You buy stocks, stocks go down or you buy bonds and bonds go down.

It is a very difficult problem to protect the funds. Of course, we are interested, but who has the magic? Some States have done better than others. It is very important. We have obligations in these pension systems, billions of dollars are not funded throughout the country among a lot of the States.

The California State teachers system alone has $10 billion underfunded. They have to start putting more money in.

I think the States are aware of this now. It is ridiculous for the Federal Government to be telling us to make the systems sound when the Federal Government doesn't want to put any more money in. Perhaps, there isn't any money to put in the Federal system, but we are putting more money in at the State level.

Texas has put so much money in that they have a surplus. So progress is being made there.

Mr. **Clay**. Mr. Bartlett.

Mr. **Bartlett**. To follow up on Mr. Duncan's question and your last statement, I suppose you are saying if we were to persist in providing the so-called Federal assistance or Federal help by this legislation, perhaps the States could assist us by getting two additional States to adopt the call for a constitutional convention to balance the budget?

Mr. **Townsend**. Yes. The only problem is that it is an off-budget item. I don't think the average Congressman knows he has another $200 billion pension deficit yearly off budget.

Mr. **Bartlett**. On two items you clarified. This legislation may in fact cause additional problems for States than the problems you are trying to solve.

One would be that there is a danger that these minimum requirements of reporting and disclosure could become the States' maximum requirement; that is to say, the States would begin to assume if they can comply with Federal law, they will have done their job and not take additional steps to cure that problem.

Mr. **Townsend**. I think that is a real problem. Politicians like to do something that doesn't cost money. As I say, it would be sort of indirect approval of the system.

Mr. **Bartlett**. Do you know of any States that still have a problem as far as disclosure and reporting where it is not known in the State what the unfunded liabilities might be?

Mr. **Townsend**. I would seriously doubt it now, as accurate as the public employee systems are. A lot of States are unionized. They are insisting on full disclosure and in many States they are on the investment board. They have a teacher or State employee or several other employees on the board.

Mr. **Bartlett**. Do you have any estimate as to the cost of this legislation to State plans in terms of the paperwork or complying with the Federal requirement?

Would it have some additional administrative cost?

Mr. **Townsend**. It definitely would because there are so many systems. It is not just a matter of getting 50 States. It is a matter of thousands of systems. It is going up every day. We have several hundred in Georgia alone.

I think it would just be a duplication and additional cost to comply. If I am going to send reports every month of every year, who is going to come down to see if the reports are correct.

We can do that and we can withhold State plans as we plan to do. It is in our bill. I have a copy of a bill I will submit for the record. This is much more strict and a lot of other States are doing the same.

[The bill follows:]

H. B. No. 219 (AS PASSED HOUSE AND SENATE)
By: Representative Johnson of the 72nd

A BILL TO BE ENTITLED

AN ACT

To amend Title 47 of the Official Code of Georgia Annotated, relating to retirement, so as to provide minimum funding standards for retirement or pension systems for employees and officials of the State of Georgia and its political subdivisions; to provide for a short title; to provide for a statement of purpose; to provide for definitions; to provide for controlling legislative procedures in connection with bills amending or creating retirement or pension systems; to provide procedures, requirements, and other matters relative to the foregoing; to provide an effective date; to repeal conflicting laws; and for other purposes.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF GEORGIA:

Section 1. Title 47 of the Official Code of Georgia Annotated, relating to retirement, is amended by adding at the end thereof a new Chapter 20 to read as follows:

"CHAPTER 20

ARTICLE 1

47-20-1. This chapter shall be known and may be cited as the 'Public Retirement Systems Standards Law.'

47-20-2. It is the purpose of this chapter to comply with the provisions of Article III, Section X, Paragraph V of the Constitution of Georgia requiring the General Assembly to enact legislation to define funding standards to assure the actuarial soundness of any retirement or pension system supported wholly or partially from public funds and to control legislative procedures so that no bill or resolution creating or amending any such retirement or pension system shall be passed by the General Assembly without concurrent provisions for funding in accordance with the defined funding standards.

47-20-3. As used in this chapter, the term:

(1) 'Accumulated retirement system benefits' means benefits that are attributable under the provisions of a retirement system to employees' service rendered to a specific valuation date.

(2) 'Actuarial accrued liability' means that portion, as determined by a particular actuarial cost method, of the actuarial present value of retirement system benefits and expenses which is not provided for by future normal costs.

(3) 'Actuarial assumptions' means assumptions as to the occurrence of future events affecting retirement system costs such as: mortality, withdrawal, disability and retirement; changes in compensation and national pension benefits; rates of investment earnings and asset appreciation or depreciation; procedures used to determine the actuarial value of assets, and other relevant items.

(4) 'Actuarial cost method' means a procedure for determining the actuarial present value of retirement system benefits and expenses and for developing an actuarially equivalent allocation of such value to time periods, usually in the form of a normal cost and an actuarial accrued liability. Acceptable actuarial cost methods are the aggregate, attained age, entry age, frozen attained

age, frozen entry age, individual aggregate, individual level, individual spread gain and unit credit methods.

(5) 'Actuarial present value' means the value of an amount or series of amounts payable or receivable at various times from a retirement system, determined as of a given date by the application of a particular set of actuarial assumptions.

(6) 'Actuarial present value of accumulated retirement system benefits' means the amount as of a valuation date that results from applying actuarial assumptions to the accumulated retirement system benefits, with the actuarial assumptions being used to adjust those benefits to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the valuation date and the expected date of payments.

(7) 'Actuarial valuation' means the determination, as of a valuation date, of the normal cost, actuarial accrued liability, actuarial value of assets, and related actuarial present values for a retirement system.

(8) 'Actuarial value of assets' means the value of cash, investments, and other property belonging to a retirement system, as used by the actuary for the purpose of an actuarial valuation.

(9) 'Actuary' means an actuary who is enrolled under Subtitle C of Title III of the federal Employee Retirement Income Security Act of 1974, P. L. 93-406.

(10) 'Amortization contribution' means the excess in total employer and employee contributions over normal cost.

(11) 'Beneficiary' means a person receiving or entitled to receive a benefit pursuant to a retirement system.

(12) 'Benefit' means any benefit, including disability benefits, which is paid or payable to a beneficiary under a retirement system.

(13) 'Benefit increase' means a change in or amendment to a retirement system which results or will result in an increase in the benefits being paid or which will be paid to a beneficiary or potential beneficiary under a retirement system and includes any change in a retirement system which decreases the requirements for becoming eligible to receive a benefit and any change which grants or authorizes a member or members of a retirement system to obtain additional creditable service under the retirement system for service rendered in a capacity other than as a member of the retirement system.

(14) 'Employee' means officials and employees of the state or of any department, board, bureau, commission, authority, or other agency thereof and the officials and employees of a political subdivision or any agency thereof who are or who become members of a retirement system.

(15) 'Employee contribution' means that part of the compensation of an employee which is paid by or on behalf of an employee as a contribution to a retirement system.

(16) 'Employer' means the State of Georgia for any retirement system financially supported in

whole or in part by appropriations made by the General Assembly, by the proceeds of a tax levied by law enacted by the General Assembly, or by fines and forfeitures or portions of fines and designated by law as a source of funding for a retirement system; and, for any retirement system supported in whole or in part by the funds of a political subdivision, 'employer' means the local governing authority authorizing or providing for the local retirement system. 145 146 147 148 149 150

(17) 'Employer contribution' means: 152

(A) Funds paid by an employer to support financially a retirement system; 154

(B) Public funds, whether by taxes, fines and forfeitures, or other sources, devoted to the financial support of a retirement system; and 156 157

(C) Any other funds, other than employee contributions, used to support financially a retirement system. 159 160

(18) 'Legislatively controlled retirement system' means a retirement system in existence on January 1, 1984, which was created by an Act of the General Assembly and which may be amended only by an Act of the General Assembly. 162 163 164

(19) 'Local governing authority' means the council, board of aldermen, board of commissioners, commissioner, or other person or body of persons entrusted by law with the administration, management, and control of the fiscal affairs of a political subdivision. 166 167 168 169

(20) 'Normal cost' means that portion of the actuarial present value of a retirement system benefits and expenses which is allocated to a 171 172

valuation year by the actuarial cost method used for the retirement system.

(21) 'Political subdivision' means any county or municipality of this state.

(22) 'Retirement bill' means any bill or resolution introduced into the General Assembly which creates or affects a retirement system.

(23) 'Retirement system' means any retirement or pension plan or any other plan or program which exists on January 1, 1984, or which is created or established on or after that date, and which is maintained by an employer or maintained pursuant to law or other authority of an employer for the purpose of paying benefits to employees or their beneficiaries after employees cease active employment by retirement, disability, death, or other termination. The term 'retirement system' shall include any plan or program which creates a retired position, commonly referred to as 'emeritus,' and provides a salary for the retired position in lieu of a retirement benefit. The term 'retirement system' shall not include an individual retirement account or other plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account and any income, expenses, gains, and losses and any forfeitures of accounts of other participants which may be allocated to a participant's account.

(24) 'Retirement system administrator' means the board of trustees or other body or individual having responsibility, either by law or by other authority of an employer, for the management and administration of a retirement system.

(25) 'Unfunded actuarial accrued liability' means the excess of the actuarial accrued liability over the actuarial value of the assets of a retirement system under an actuarial cost method which so provides.

ARTICLE 2

47-20-10. (a) In order to assure the actuarial soundness of each retirement system, the minimum annual employer contribution for each retirement system, unless excepted by Code Section 47-20-13, shall be the sum of the amounts determined under paragraphs (1), (2), and (3) of this subsection minus the amount determined under paragraph (4) of this subsection.

(1) The normal cost of the retirement system for the year; plus

(2) The amounts necessary to amortize:

(A) The unfunded actuarial accrued liability over a period of 40 years in the case of a retirement system in existence on January 1, 1983, based on the first actuarial valuation of the retirement system which is made on or after January 1, 1984; or

(B) The unfunded actuarial accrued liability over a period of 30 years in the case of a retirement system which is created or established after January 1, 1983, based on the first actuarial valuation of the retirement system; plus

(C) The increase, if any, in unfunded actuarial accrued liability over a period of 20 years for any such increase which occurs after January 1, 1984, during any year as a result of changes made in the provisions of the retirement system affecting active employees; plus

(D) The increase, if any, in unfunded actuarial accrued liability over a period of 15 years for any such increase which occurs from experience under the actuarial assumptions applicable to the retirement system; plus

(E) The increase, if any, in unfunded actuarial accrued liability over a period of 30 years for any such increase resulting from changes in actuarial assumptions applicable to the retirement system; plus

(3) If not otherwise included in the calculations under paragraphs (1) or (2) or (1) and (2) of this subsection:

(A) The amount necessary to amortize over a period of ten years in equal annual installments the increase, if any, in unfunded actuarial accrued liability resulting from benefit increases granted during the year to beneficiaries under the retirement system; or

(B) The amount necessary to pay the amount of increase in benefits granted during the year to beneficiaries under the retirement system on a current disbursement or pay as you go basis; minus

(4) The amount:

(A) Necessary to amortize the decrease, if any, in unfunded actuarial accrued liability over a period of 20 years for any such decrease which occurs after January 1, 1984, during any year as a result of changes made in the provisions of the retirement system; plus

(B) Necessary to amortize the decrease in unfunded actuarial accrued liability, if any, over a period of 15 years for any such decrease which occurs from experience under the actuarial assumptions applicable to the retirement system; plus

(C) Necessary to amortize the decrease in unfunded actuarial accrued liability, if any, over a period of 30 years for any such decrease resulting from changes in the actuarial assumptions applicable to the retirement system; plus

(D) In excess of the minimum annual employer contribution required by this Code section which accumulates after January 1, 1984; plus

(E) Employee contributions for the year.

(b) In the case of a retirement system which uses a formula related to the compensation of the members of the retirement system as a basis for the calculation of benefits under the retirement system, the amortization amounts required by subsection (a) of this Code section, except for the amount determined under paragraph (3) of said subsection (a), may be determined as a level percentage of future compensation. If such level percentage amortization is used, the actuarial assumption for future annual payroll growth shall not exceed the actuarial assumed valuation interest rate of the retirement system less 2 1/2 percent. If such level percentage amortization is used, the amortization of increases and decreases in unfunded actuarial accrued liability under subsection (a) of this Code section need not be reflected in the amortization contribution otherwise determined if the amortization contribution so determined is at least 4 percent of the unfunded actuarial accrued liability for the period up to January 1, 1989, and at least 4 1/2 percent of the unfunded actuarial accrued liability after January 1, 1989.

(c) In determining the minimum annual employer contribution under subsection (a) of this Code section:

(1) All benefits which it is reasonable to anticipate will be paid from the retirement system because of the current active members and payments to beneficiaries shall be taken into account; and

(2) All costs, liabilities, and other factors under the retirement system shall be determined by an actuary on the basis of an actuarial cost method and actuarial assumptions which, in the aggregate, are reasonable, considering the experience of the retirement system and reasonable expectations, and which, in combination, offer the actuary's best estimate of anticipated experience under the retirement system.

(d) Upon completion of the first actuarial investigation of a retirement system after January 1, 1984, and for each subsequent actuarial investigation, the minimum annual employer contribution required by this Code section shall be increased by an amount equivalent to the interest earned on such minimum annual employer contribution, based on the actuarial assumed valuation interest rate applicable to the retirement system, from the date of such actuarial investigation until the date the minimum annual employer contribution is made to the retirement system. This subsection shall not apply to a retirement system to which annual employer contributions are being made in excess of the minimum annual employer contribution required by this Code section.

(e) In no event will employee contributions of active members of a retirement system be used to pay benefits to beneficiaries under the retirement system.

47-20-11. In the case of a retirement system of a political subdivision, if the minimum funding standards provided by Code Section 47-20-10 would cause a severe financial hardship to the political subdivision if implemented on January 1, 1984, such minimum funding standard may be phased in over a period of four years beginning on January 1, 1984, for funding the normal cost and over a period of seven years beginning on January 1, 1984, for funding the total required minimum employer contribution. The provisions of this Code section shall not apply to any retirement system of a political subdivision which is created or established on or after January 1, 1983.

47-20-12. (a) The retirement system administrator of each legislatively controlled retirement system, based on the findings and conclusions of the actuary of the retirement system, shall submit a certification to the Governor and to each member of the General Assembly by not later than July 1, 1984, stating whether or not the retirement system is currently being funded in conformity with the minimum funding standards set forth in Code Section 47-20-10.

(b) Based on the certification provided for by subsection (a) of this Code section, any legislatively controlled retirement system which is not being funded in conformity with the minimum funding standards set forth in Code Section 47-20-10 shall not be amended or changed in any manner to grant any benefit increase until such time as the retirement system administrator, based on the findings and conclusions of the actuary of the retirement system, issues a new certification to the

Governor and to each member of the General Assembly stating that the retirement system is being funded in conformity with the minimum funding standards set forth in Code Section 47-20-10.

(c) Based on the certification provided for by subsection (a) of this Code section, the retirement system administrator of any legislatively controlled retirement system which is not being funded in conformity with the minimum funding standards set forth in Code Section 47-20-10 shall not take any action to grant a benefit increase until such time as a new certification provided for by subsection (b) of this Code section is issued by the retirement system administrator. The provisions of any law relating to a legislatively controlled retirement system which authorizes the retirement system administrator to grant benefit increases from time to time is amended to conform with the requirements of this subsection.

(d) Any retirement bill introduced into the General Assembly in violation of subsection (b) of this Code section shall not be considered by the House or Senate or by any committee of the House or Senate. Any retirement bill in violation of subsection (b) of this Code section which is enacted by the General Assembly, whether or not the bill is approved by the Governor, shall not become law and shall be null, void, and of no force and effect and shall stand repealed in its entirety on the first day of July immediately following its enactment.

47-20-13. The minimum funding standards specified by Code Section 47-20-10 shall not apply to a retirement system which holds actuarial assets in excess of 150 percent of the actuarial present value of the accumulated retirement system benefits.

ARTICLE 3

47-20-20. (a) In the case of a retirement system of a political subdivision, unless excepted by Code Section 47-20-13, neither the local governing authority by ordinance or resolution or other action nor the retirement system administrator shall take any action on or after January 1, 1984, to grant a benefit increase under any retirement system of the political subdivision until annual employer contributions to each retirement system of the political subdivision are in conformity with the minimum funding standards specified by Code Section 47-20-10. The local governing authority of a political subdivision shall not take any action after January 1, 1984, to create or establish any new retirement system until all existing retirement systems of that political subdivision are being funded in conformity with the minimum funding standards specified by Code Section 47-20-10. This limitation shall not prohibit a local governing authority from creating or establishing a new retirement system as a successor to the existing retirement system or systems of the political subdivision if the resulting new system and the remaining obligations under the previously existing system or systems are funded in accordance with the minimum funding standards specified by Code Section 47-20-10. The membership of such a successor retirement system need not be confined to the membership of the previously existing retirement system or systems.

(b) Unless excepted by Code Section 47-20-13 and subject to the provisions of Code Section 47-20-11, after January 1, 1984, the annual employer contribution to each retirement system of a political subdivision shall be in an amount equal to or greater than the minimum annual employer contribution required by Code Section 47-20-10.

47-20-21. (a) The retirement system administrator of each retirement system of a political subdivision shall comply fully with the requirements of Code Section 47-1-3 requiring the employment of an actuary and the completion of actuarial investigations once every three years. In addition to the other requirements specified by Code Section 47-1-3 for such actuarial investigations, each such investigation shall express the actuary's opinion, which shall be supported by such analysis as the actuary determines necessary, of the status of the retirement system with regard to the minimum funding standards specified in Code Section 47-20-10. Each such actuarial investigation shall also include an analysis of each change in or amendment to the retirement system since the previous investigation and shall identify any change or amendment which granted a benefit increase.

(b) If an actuarial investigation or a financial report which is submitted to the state auditor under Code Section 47-1-3 shows that an amendment or change was made in a retirement system of a political subdivision granting a benefit increase in violation of subsection (a) of Code Section 47-20-20 or shows that a retirement system of a political subdivision is not in conformity with the requirements of subsection (b) of Code Section 47-20-20, it shall be the duty of the state auditor to notify the director of the Fiscal Division of the Department of Administrative Services; and it shall be the duty of the director to withhold any state funds payable to the applicable political subdivision until the actuary of the applicable retirement system certifies to the state auditor and to the director that employer contributions to each retirement system of the political subdivision are in conformity with the minimum funding standards specified in Code Section 47-20-10.

(c) The report on the condition of local retirement systems submitted to the Governor and to members of the General Assembly pursuant to Code Section 47-1-4 shall include a separate list of each retirement system of each political subdivision which is not in conformity with the minimum funding standards specified by Code Section 47-20-10 and a separate attachment giving a full explanation of any action taken pursuant to subsection (b) of this Code section.

ARTICLE 4

Part 1

47-20-30. As used in this article, the term:

(1) 'Amendment' means any amendment, including a substitute bill, made to a retirement bill by any committee of the House or Senate or by the House or Senate.

(2) 'LC number' means that number preceded by the letters 'LC' assigned to a bill by the Office of Legislative Counsel when that office prepares a bill for a member of the General Assembly.

(3) 'Nonfiscal amendment' means an amendment to a retirement bill having a fiscal impact, which amendment does not change any factor of an actuarial investigation specified in subsection (a) of Code Section 47-20-36.

(4) 'Nonfiscal retirement bill' means any retirement bill other than one defined by paragraph (5) of this Code section.

(5) 'Retirement bill having a fiscal impact' means:

(A) Any retirement bill having the effect of creating or establishing a new retirement system; or 464 465

(B) Any retirement bill granting a benefit increase under a retirement system or affecting employer contributions, employee contributions, the normal cost, or the actuarial accrued liabilities of a retirement system. 467 468 469

47-20-31. No retirement bill may be introduced by any member of the General Assembly unless, at the time of its introduction, the bill has printed thereon in the upper right portion of each page of the bill an LC number. Once a retirement bill is presented by the Office of Legislative Counsel to a member of the General Assembly, neither the Office of Legislative Counsel nor any person shall make any change in the retirement bill prior to its introduction into the General Assembly unless the bill is returned to the Office of Legislative Counsel and that office assigns a new LC number to the bill. 471 472 473 474 475 476 477 478 479

Part 2 482

47-20-32. (a) A nonfiscal retirement bill may be introduced at any regular session of the General Assembly, but it must be introduced during the first ten days of a regular session. As a condition precedent to the introduction of a nonfiscal retirement bill, the member of the General Assembly who intends to be the primary sponsor of the bill must present an exact copy of the proposed bill, which must bear an LC number, to the state auditor. If the state auditor finds that the proposed bill is a nonfiscal retirement bill, said officer shall provide a written certification to that 485 486 487 488 489 490 491 492 effect to the member of the General Assembly who intends to be the primary sponsor of the bill. Such certification shall specifically identify the proposed bill by reference to the LC number. If the proposed bill is introduced into the General Assembly, it shall have attached thereto the original of the certification of the state auditor that the bill is a nonfiscal retirement bill. If the LC number on the bill as offered for introduction is different from the LC number shown on the state auditor's certification or if the bill as offered for introduction does not bear an LC number on each page of the bill, the bill may not be accepted for introduction by the Secretary of the Senate or the Clerk of the House of Representatives, and the bill may not be considered by any committee of the House or Senate or by the House or Senate.

(b) If the state auditor is unable to determine that a proposed retirement bill presented to him under subsection (a) of this Code section is a nonfiscal retirement bill, said officer shall not issue a certification under said subsection, and the bill shall be considered a retirement bill having a fiscal impact for all purposes under this article.

47-20-33. (a) After its introduction into the General Assembly, a nonfiscal retirement bill may not be amended in any manner to cause the bill to become a retirement bill having a fiscal impact. Any amendment to a nonfiscal retirement bill shall be submitted to the state auditor. Any such amendment shall be submitted to the state auditor by the chairman of the committee, if a committee amendment, or by the presiding officer of the Senate or House if the amendment was made by the Senate or House. If the state auditor certifies in writing that the amendment does not cause the bill to become a retirement bill having a fiscal impact, the bill, as amended, may continue in the legislative process as any other bill. If the state auditor will not certify that the amendment does not cause the bill to become a retirement bill having a fiscal impact or if the state auditor issues a written opinion that the amendment will cause the bill to become a retirement bill having a fiscal impact, the bill's progress in the legislative process will end, and the bill shall not be considered further by either the House or the Senate and shall not be passed by the General Assembly, and, if passed by the General Assembly, the bill shall not become law and shall be null, void, and of no force or effect and shall stand repealed in its entirety on the first day of July immediately following its enactment.

(b) If a nonfiscal retirement bill is amended to cause the bill to become a retirement bill having a fiscal impact, the amendment may be removed or changed by the committee which made the amendment, if a committee amendment, or by the Senate, if that body made the amendment, or by the House, if that body made the amendment. The version of the bill, with the amendment removed or changed, shall be submitted to the state auditor. If the state auditor certifies in writing that the version of the bill presented to that officer is a nonfiscal retirement bill, the bill may continue in the legislative process as any other bill, unless it is subsequently amended, and, in that event, this Code section shall apply to the subsequent amendment.

(c) A nonfiscal retirement bill which is not amended during the legislative process may be considered as any other bill.

Part 3

47-20-34. (a) Any retirement bill having a fiscal impact may be introduced in the General Assembly only during the regular session which is held during the first year of the term of office of members of the General Assembly. Any such retirement bill may be passed by the General Assembly only during the regular session which is held during the second year of the term of office of members of the General Assembly.

(b) When a retirement bill having a fiscal impact is introduced, it shall be assigned by the presiding officer of the Senate or the House, as the case may be, to the respective Senate or House standing committee on retirement. If a majority of the total membership of the respective committee is opposed to the bill on its merits, no actuarial investigation provided for in Code Section 47-20-36 shall be necessary, and the bill shall not be reported out by the committee and shall not be adopted or considered by the House or Senate. If a majority of the committee wishes to consider the bill further and votes in favor of an actuarial investigation of the bill, an actuarial investigation shall be required as provided in Code Section 47-20-36. No retirement bill having a fiscal impact may be reported out of the committee to which it is assigned or may be considered or adopted by the House or Senate unless an actuarial investigation of the bill is made.

47-20-35. (a) A retirement bill having a fiscal impact which the committee wishes to consider shall first be perfected, if necessary, by the committee. The committee may delay further consideration of the bill until after the close of the regular session during which the bill was introduced, but the committee shall complete its consideration of the bill for submission to the state auditor under Code Section 47-20-36 by not later than the first day of July immediately following the close of the legislative session. If the committee delays consideration until after the close of the session, it shall be authorized to meet not more than five days during the period beginning with the day following the close of the session and ending on June 15 immediately following the close of the session for the purpose of considering and perfecting the bill. If the bill originated in the Senate, the House Committee on Retirement shall be authorized to meet jointly with the Senate Committee on Retirement to consider and perfect a bill during the period following the close of a regular session, and, if the bill originated in the House, the Senate Committee on Retirement shall have the same authority. For attending meetings of their respective committees as authorized by this subsection, the members of the Senate and House committees on retirement shall receive the expenses and allowances provided by law for members of legislative interim committees. If a retirement bill having a fiscal impact is changed by the committee to which it is assigned, such change shall be accomplished only by a substitute bill, and no committee amendment to the bill, except by substitute, shall be authorized.

(b) Immediately after a retirement bill having a fiscal impact has been considered and perfected as provided in subsection (a) of this Code section, the chairman of the committee to which the bill was assigned shall transmit an exact copy of the bill, as perfected by the committee, when applicable, to the state auditor. The copy submitted to the state auditor shall bear an LC number. The submission of the bill to the state auditor shall have attached thereto a letter signed by the chairman of the committee requesting the state auditor to make or cause to be made an actuarial investigation on the bill.

47-20-36. (a) If an actuarial investigation of a retirement bill having a fiscal impact is requested under Code Section 47-20-35, it shall be the duty of the state auditor to complete or cause to be completed such actuarial investigation by not later than December 1 of the same year during which the request for the actuarial investigation was made. The actuarial investigation shall include, but shall not be limited to, findings on the following factors as such factors are relevant to the retirement bill under consideration:

(1) The dollar amount of the increase in unfunded actuarial accrued liabilities which will result for the retirement system affected if the bill affects an existing retirement system;

(2) The dollar amount of unfunded actuarial accrued liabilities which will be created if the bill creates a new retirement system;

(3) The dollar amount of increase, on an annual basis, in the normal cost of the retirement system if the bill affects an existing retirement system;

(4) The dollar amount, on an annual basis, of the normal costs which will be incurred if the bill creates a new retirement system;

(5) A statement of the current employer contribution rate in effect for the retirement system if the bill affects an existing retirement system;

(6) A finding of whether or not the current employer contribution rate under paragraph (5) of

this subsection is in conformity with the minimum funding standards specified by Code Section 47-20-10;

(7) A statement of the recommended current employer contribution rate if, under paragraph (6) of this subsection, the current employer contribution rate is not in conformity with the minimum funding standards specified by Code Section 47-20-10;

(8) A statement of the employer contribution rate, which must be in conformity with the minimum funding standards specified by Code Section 47-20-10, recommended if the bill amends an existing retirement system;

(9) A statement of the employer contribution rate, which must be in conformity with the minimum funding standards specified by Code Section 47-20-10, recommended if the bill creates a new retirement system; and

(10) A statement of the dollar amount of the annual employer contribution which will be necessary to maintain the retirement system affected or established by the bill in an actuarially sound condition.

(b) Upon its completion, an actuarial investigation shall be submitted by the state auditor to the chairman of the committee which requested it along with the following:

(1) A statement that the actuarial investigation is for the particular retirement bill, identified by LC number, submitted to the state auditor and that subsequent changes in the retirement bill will invalidate the actuarial investigation and the findings included therein; and

(2) A summary of the actuarial investigation which shall include the relevant findings specified in subsection (a) of this Code section.

(c) The chairman of the committee, upon receipt of the information provided for under subsection (b) of this Code section, shall cause the material submitted to such chairman under paragraphs (1) and (2) of said subsection to be printed by the Secretary of the Senate or the Clerk of the House of Representatives, depending on whether the bill is a Senate bill or House bill, in sufficient quantity to attach a copy thereof to all printed copies of the bill. The original of such material shall be attached by the Secretary of the Senate or Clerk of the House of Representatives to the original version of the substitute bill, as perfected by the committee under Code Section 47-20-35, if applicable, or to the original version of the bill as introduced if the bill was not changed by the committee prior to its submission to the state auditor for an actuarial investigation.

47-20-37 (a) When a retirement bill having a fiscal impact has had an actuarial investigation pursuant to Code Section 47-20-36, the bill may be considered at the next regular session of the General Assembly. If the bill as originally introduced was not changed by the committee and the original version was submitted to the state auditor for an actuarial investigation, then the original version of the bill is the only one, except as otherwise provided by subsection (b) of this Code section, which may be considered by any committee or by the House or Senate. If the original bill was substituted by the committee and the substitute version was the one submitted to the state auditor, then that substitute bill is the only one, except as otherwise provided by subsection (b) of this Code section, which may be considered by any committee or by the House or Senate.

(b) After completion of an actuarial investigation, any amendment to a retirement bill having a fiscal impact shall be out of order and shall not be allowed either by a committee or by the House or Senate, except for a nonfiscal amendment. Any amendment to a retirement bill having a fiscal impact shall be submitted to the state auditor by the chairman of the committee, if a committee amendment, or by the presiding officer of the Senate or House if the amendment was made by the Senate or House. If the state auditor certifies in writing that the amendment is a nonfiscal amendment, then the bill as amended, with the state auditor's certification attached to the original of the amendment, may continue in the legislative process. If the state auditor will not certify that the amendment is nonfiscal or if the state auditor issues a written opinion that the amendment changes any factor of an actuarial investigation specified in subsection (a) of Code Section 47-20-36, the bill's progress in the legislative process will end, and the bill shall not be considered further by either the House or Senate and shall not be passed by the General Assembly, and, if passed by the General Assembly, the bill shall not become law and shall be null, void, and of no force and effect and shall stand repealed in its entirety on the first day of July immediately following its enactment.

(c) An amendment to a retirement bill having a fiscal impact which affects a factor of an actuarial investigation specified in subsection (a) of Code Section 47-20-36 may be removed or changed so that no such factor is affected by the amendment by the committee which made the amendment, if a committee amendment, or by the Senate, if that body made the amendment, or by the House, if that body made the amendment. The version of the bill with the amendment removed or changed shall be submitted to the state auditor. If the state auditor certifies in writing that the factors of an actuarial investigation specified in subsection (a) of Code Section 47-20-36 are not changed by the version of the bill submitted to that officer, then that version of the bill may continue in the legislative process unless it is subsequently amended, and, in that event, this Code section shall apply to the subsequent amendment.

ARTICLE 5

47-20-50. (a) Any retirement bill having a fiscal impact which is enacted by the General Assembly and which is approved by the Governor or which otherwise becomes law shall become effective on the first day of July immediately following the regular session during which it was enacted, but only if the enacted bill is concurrently funded as provided by this Code section. If an enacted bill, including one approved by the Governor, is not concurrently funded as required by this Code section, then such bill may not become effective as law and shall be null, void, and of no force and effect and shall stand repealed in its entirety on the first day of July immediately following its enactment.

(b) When a retirement bill having a fiscal impact amends a retirement system having employer contributions funded from appropriations by the General Assembly, then appropriations for the first fiscal year of effectiveness of the bill, after it becomes law, must include funds to pay the amount determined by the actuarial investigation under paragraph (10) of subsection (a) of Code Section 47-20-36, and future appropriations for subsequent fiscal years must include an amount necessary to maintain the actuarial soundness of the retirement system in accordance with the findings of the actuarial investigation. Any limitation on the rate of employer contributions that may be included in a law which is the source of authority for a retirement system affected by this subsection is amended to the extent necessary to comply with the requirements of this subsection.

(c) When a retirement bill having a fiscal impact amends a retirement system having employer contributions funded from portions of fines and forfeitures, then, if necessary to produce funds to pay the amount determined by actuarial investigation under paragraph (10) of subsection (a) of Code Section 47-20-36, either:

(1) The retirement bill having a fiscal impact or parallel legislation, which must become effective concurrently with the retirement bill, must revise the portion of fines and forfeitures designated for employer contributions to pay the amount determined under paragraph (10) of subsection (a) of Code Section 47-20-36; or

(2) The General Assembly by direct appropriations must supplement employer contributions from fines and forfeitures to the extent necessary to pay the amount determined under paragraph (10) of subsection (a) of Code Section 47-20-36.

(d) When a retirement bill having a fiscal impact amends a retirement system having employer contributions funded from the designation of the proceeds of a tax imposed by law, then either:

(1) The retirement bill having a fiscal impact or parallel legislation, which must become effective concurrently with the retirement bill, must revise the tax as necessary to pay the amount determined under paragraph (10) of subsection (a) of Code Section 47-20-36; or

(2) The General Assembly by direct appropriation must supplement employer contributions from the tax to the extent necessary to pay the amount determined under paragraph (10) of subsection (a) of Code Section 47-20-36.

(e) When a retirement bill having a fiscal impact amends a retirement system having employer contributions funded wholly or partially from the funds of a political subdivision, that political subdivision shall have a duty to produce funds as necessary to pay all or its proportionate share of the amount determined by actuarial investigation under paragraph (10) of subsection (a) of Code Section 47-20-36.

(f) When a retirement bill having a fiscal impact creates a new retirement system, then employer contributions in conformity with the minimum funding standards of Code Section 47-20-10 and in conformity with paragraph (10) of subsection (a) of Code Section 47-20-36 must be made to the retirement system either by direct appropriations by the General Assembly or by another source of employer contributions specifically provided for in the bill creating the new retirement system.

47-20-51. No provision of this chapter generally and no provision of Code Section 47-20-50 in particular shall:

(1) Create or be construed to create a contractual right to a retirement benefit or a

contractual right in the provisions of a retirement system law which does not exist independently of the provisions of this chapter; and

(2) Impair, alter, or diminish or be construed to impair, alter, or diminish a contractual right to a retirement benefit or a contractual right in the provisions of a retirement system law which exists independently of the provisions of this chapter.

ARTICLE 6

47-20-60 (a) The state auditor shall be authorized to employ or contract with actuaries and other personnel to carry out the duties assigned to that officer by this chapter. Upon their approval by the Legislative Services Committee, expenses incurred by the state auditor in carrying out such duties shall be paid from funds appropriated or available to the legislative branch of the state government. When authorized to do so by the Legislative Services Committee, and such authorization may be on a continuing basis by direction of the Legislative Services Committee entered upon its minutes, the legislative fiscal officer, upon certification by the state auditor of expenses incurred to carry out the duties assigned to that officer by this chapter, is authorized to expend legislative funds to pay such expenses.

(b) Retirement system administrators, state officials and employees, and officials and employees of political subdivisions are authorized and directed to cooperate with and assist the state auditor in carrying out the duties assigned to that officer by this chapter.

47-20-61. The enrolled Act resulting from a bill which is subject to the legislative procedures provided by this chapter shall have attached thereto the original or a true and correct copy of all certificates and summaries of actuarial investigations submitted by the state auditor pursuant to the requirements of this chapter.

47-20-62. This chapter shall become effective on January 1, 1984. Only nonfiscal retirement bills may be introduced at the 1984 regular session of the General Assembly. Retirement bills having a fiscal impact which were introduced at the 1983 regular session and which are still pending at the 1984 regular session shall be subject to the requirements of Code Section 47-20-50, except that the amount determined by actuarial investigation under paragraph (10) of subsection (a) of Code Section 47-20-36 shall be determined by the director of the Office of Planning and Budget and the state auditor pursuant to Code Sections 28-5-42 and 28-5-43, relating to fiscal notes."

Section 2. This Act shall become effective on January 1, 1984.

Section 3. All laws and parts of laws in conflict with this Act are repealed.

Mr. BARTLETT. The pension task force voted, in their opinion, there is uncertainty and variation with the regulatory statutory provisions of the Internal Revenue Code governing these plans.

Do you see that ambiguity and do you think there is need for clarifying legislation to make sense out of the existing regulatory scheme?

Mr. TOWNSEND. I think a lot of States thought they couldn't comply and we have had a lot of people worrying. I think you will find that most, if not all States have complied or can comply without a whole lot of changes. We don't hear a lot of static about that part of it any more.

Mr. BARTLETT. As far as uncertainty or ambiguity with the existing Internal Revenue Code, you don't see that as a problem?

Mr. TOWNSEND. It has not come to a head yet either because they have postponed compliance. I am not an expert on clarifying IRS regulations.

Mr. BARTLETT. I thank the chairman.

Mr. CLAY. Thank you, Mr. Bartlett.

When you were talking about people out in California who represent employees on the fund committee, is it true that one of the directors of the fund out there just recently ran off with over $50 million and there may be no fiduciary law in California that can do anything about it? There may be a criminal statute.

Mr. TOWNSEND. He ran out with $50 million?

Mr. CLAY. Yes.

Mr. TOWNSEND. I take your word for it if he did. I didn't know about that. I didn't see that in the paper.

Mr. CLAY. Well, that is true.

Mr. TOWNSEND. They don't have any bonding requirement?

Mr. CLAY. I doubt it.

Mr. TOWNSEND. I don't understand how you could prevent a crook running off by this paperwork, how that would stop fraud.

Mr. CLAY. Fiduciary standards would make him personally liable. They may know where he is. They just can't get the $50 million.

Mr. TOWNSEND. He is not liable?

Mr. CLAY. No.

Mr. TOWNSEND. They are not going to prosecute him?

Mr. CLAY. They would have to do it under a criminal statute, but I doubt they can get the money back.

You mentioned $10 million unfunded liability for the teachers' plan in California.

Did you realize that just recently the Governor announced he was only going to contribute $1 this year to that unfunded liability?

Mr. TOWNSEND. I know they had a big thing about proposition 13. I don't know how you cure that, really.

Mr. CLAY. He could have signed the bill that required him to do something about that underfunded liability, but he vetoed the bill.

Mr. TOWNSEND. Your regulations would not go to that.

Mr. CLAY. You have been sitting here telling us about all the progress that is being made. The only reason that the public knows that the Governor is offering to contribute $1 this year to that unfunded liability is because the State law requires him to report.

In most of the States you are sitting here protecting, there is no requirement that the Governor say what he is going to contribute to the unfunded liability.

All we are saying to you with this piece of legislation is that we ought to have a standard and it ought to be uniform across this country.

People who contribute and taxpayers who subsidize ought to know what is happening to their money.

Unless there are other questions, I want to thank you for your testimony.

Mr. TOWNSEND. I want to thank you for your efforts. I am glad you have focused so much attention on the whole pension problem, Mr. Chairman.

Mr. CLAY. Mr. Pickle, did you have any questions?

Mr. PICKLE. Mr. Chairman, I don't think I have many questions at this time. We have several panels and I have some representation from my State which I want to hear.

I take it, Mr. Townsend, you are saying we ought to have standards for protection, but it can be done by the States just as well as by the Federal Government.

I have an innate feeling that there are some things that can be done without Federal Government interference. If the States can do it and are doing it, then that protection is offered. The State legislature can always respond to any violation.

I am going to listen to all the testimony, but I think there is a problem with respect to underfunded liability and that this will probably be the most critical problem facing the American people in the next 10 years.

Mr. TOWNSEND. I agree with you entirely.

Mr. PICKLE. It is very serious. I think most of the members will try to ask themselves, is there protection, will there be protection of these funds?

If there is protection on a State level, then I am one who is led to say let us let the States do it, but I want to be certain about that.

Mr. CLAY. Mr. Rangel.

Mr. RANGEL. I want to thank you, Representative Townsend.

I agree with Mr. Pickle that it is not abundantly clear whether the Federal Government is already enforcing existing law which relates to their responsibility to these unfunded pension funds or whether or not the investment has been proper.

One of the reasons why I believe the IRS has been reluctant to enforce the law is because unlike the private pension sector here, only the employees would suffer as a result of withholding preferential tax treatment.

There may be a call on us to give some pretty definite guidelines as to how far the Congress is prepared to go in enforcing the law.

I would hope somewhere along these lines your association would be of some assistance in how to enforce existing Federal law because if we are not doing our Federal responsibility and we have to rely on your association, I think the taxpayer is losing out on the local and State level.

Mr. TOWNSEND. I agree. We will be glad to cooperate and get up any statements you need from the different States. We will do that on our part and will be glad to push in those areas that are not——

Mr. **Rangel**. It takes a lot of political courage to resist protection for the employees.

Mr. **Townsend**. In all honesty, this position is not difficult for me because virtually no State employees live in my district. I am always kidded by the teachers. They say, "Kil Townsend is in the district, but the only teacher constituents he has are three headmasters of three private schools."

I do feel strongly about this subject, and I have spent a lot of time on it in the last 15 years. I am glad to see this much interest.

At the Federal level you could not interest anybody, as you know, 10 or 15 years ago on this subject.

Thank you.

[Subsequently, the following was submitted:]

SUPPLEMENTARY STATEMENT OF REPRESENTATIVE KILIAEN TOWNSEND, STATE LEGISLATOR, STATE OF GEORGIA, ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES

Thank you for this opportunity to submit an additional statement for the record.

In response to Mr. Rangel's first question, I want to emphasize my view that Internal Revenue Service regulation of state and local retirement systems is inappropriate. I am not, for one thing, convinced that Congress intended for IRS qualification standards to apply to state and local governments. My understanding is that when Congress in 1926 provided a tax preference for pension plans, the rationale was to avoid any disincentive for savings within private pension plans. The same rationale does not apply to a state or local government because it does not, as sponsor of a retirement system, constitute a taxable entity; thus the statutory ground for IRS regulation may be unsound. In any case the constitutional ground for IRS regulation of public plans is unsound. The IRS has no business regulating public retirement plans because personnel compensation including pension rights is fundamental to state sovereignty and under our constitutional system should be left to the states. And, federal interference would be bad policy in any case. The IRS has no expertise in this area and ought not to blindly apply private sector rules to state and local governments absent any evidence of serious abuse of the kind that prompted Congress to enact ERISA legislation covering private plans. Furthermore, as Mr. Rangel correctly pointed out, the only people who would suffer as the result of withholding preferential tax treatment from state and local pension plans would be public employees.

In response to Mr. Rangel's second question, I have additional information on the funding of state and local pension plans. According to an analysis of 1982 census data by the Employee Benefit Research Institute, state and local government pension plans are better funded than they were in 1977, as assets increased more than 13 percent per year during that five year period. Contributions for state and local pension plans increased by more than 10.5 percent per year during the same period. And total assets in state and local plans increased from $124 billion in 1977 to more than $245 billion in 1982.

Using the ratio of plan assets to annual benefit payments as an indicator of financial status, state and local pension plans appear sound with a funding ratio of 15.6:1. This represents an improvement over the 14.6:1 funding ratio for state and local plans in 1977. It also compares well to private pension plans which reported a funding ratio of 14.2:1 and to the federal retirement system which reported a funding ratio of 5.2:1.

Finally, in response to Mr. Bartlett's question, I have additional information related to state reporting procedures. The National Conference of State Legislatures in cooperation with the Advisory Commission on Intergovernmental Relations conducted a survey in 1979 of state and local government pension systems and determined that reporting and disclosure requirements were extensive for the large state systems that involve 90 percent of all state and local pension participants. Most states required regular actuarial valuations, audits, fiscal notes, and reporting to employees. A table summarizing the NCSL/ACIR survey findings is attached.

More recent information of state reporting requirements has been developed by the National Council on Teacher Retirement. (The NCTR study is attached.)[1] The

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[1] The study has been retained in the committee files.

NCTR study of twelve state teacher retirement plans concludes that state regulation of reporting, disclosure, and fiduciary standards of public pension plans is more than adequate. All of the plans are reviewed by an auditor and by an independent actuary. Such reviews are annual in most of the surveyed states. State pension review commissions in 10 states review plans for fund performance, including the actuarial valuation. All twelve states publish summary plan descriptions and annual reports that satisfy the relevant requirements of the proposed House legislation. In addition to the state requirements specifically relating to the retirement plans, all of the plans are subject to other reporting requirements including open records laws, sunshine laws, freedom of information acts, and state administrative procedure acts.

Table 10

STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR MA
STATE-ADMINISTERED SYSTEMS
(based on ACIR-NCSL survey, 1979)

States	Regular* Actuarial Valuation (Frequency Required, If Not Annual)	Regular* Audit (Frequency Required, If Not Annual)	Regular* Reports To State and/or Local (Frequency Required, If Not Annual)	Regular Reports Available to Employees	Fiscal Notes
Alabama	Yes	Yes[1,2](2 yr)	Yes	Yes[3]	Yes
Alaska	Yes[4](2-5 yr)	No[2]	Yes[5]	—	Yes
Arizona	Yes[6](1-2 yr)	Yes[7]	Yes[7]	Yes[8]	—[9]
Arkansas	Yes(2 yr)	Yes[1]	Yes	—	Yes[10]
California	Yes	Yes	Yes	—	Yes
Colorado	Yes[11,12]	No[11,13]	Yes[11]	Yes[11,14]	Yes[11]
Connecticut	Yes[15](2-5 yr)	Yes[1]	Yes	Yes[16]	Yes
Delaware	Yes[17](2 yr)	Yes[1,17]	Yes[17]	Yes[17,3]	Yes[18]
Florida	Yes(3 yr)	Yes[19]	Yes	Yes[3]	Yes[20]
Georgia	Yes[21]	Yes[21]	Yes[21]	Yes[21]	Yes
Hawaii	Yes	No	Yes	Yes	No

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* The frequency required by statute may not be the same as that which prevails in practice. Moreov are recorded as having no statutory requirement, though in practice they have regular actuarial and reports, as indicated in the footnotes. In many cases the information refers only to a sub local-administered retirement systems—though in most cases, the major local-administered sys As a result of these caveats, one must be very careful in interpreting this information.

** Percent refers to all local administered systems, while survey data may pertain only to a subset

[1] By state auditor or auditing committee.
[2] In practice, annual, independent audits are performed.
[3] Information sent or distributed to employees, annually.
[4] Refers to Alaska Public Employees' Retirement System (PERS), every two years; teachers years.
[5] Refers to Alaska PERS.
[6] Refers to Arizona State Retirement System (ASRS), annually; and public safety system, every
[7] Refers to ASRS and the public safety system.
[8] Refers to ASRS.
[9] Required for ASRS, not for public safety system, but it provides cost estimates as a matter
[10] In practice, some controversial measures "sneaked through" without fiscal note.
[11] Refers to PERA.
[12] Judicial division exempted by law but follows law in practice.
[13] Reports must be filed, however, with legislative audit committee, and in practice, the retirem annual, independent audits.
[14] In practice, two reports are sent annually to each employee, though there are no requirements.
[15] The frequency required varies among the systems.
[16] Refers to state employees' retirement system.
[17] Refers to the public officers' and employees' pension plan.
[18] Benefit improvements must also be accompanied with first year full funding in appropriations.
[19] State auditor conducts ongoing audit.
[20] Public hearing is also required prior to enactment.
[21] Refers to the Employees' Retirement System of Georgia.

Table 10 (continued)

STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR MAJOR STATE-ADMINISTERED SYSTEMS

(based on ACIR-NCSL survey, 1979)

States	Regular* Actuarial Valuation (Frequency Required, If Not Annual)	Regular* Audit (Frequency Required, If Not Annual)	Regular* Reports To State and/or Local (Frequency Required, If Not Annual)	Regular Reports Available to Employees	Fiscal Notes	EXHIBIT** Percent of Total State-Local Employees Covered by Local-Administered Systems
Idaho	Yes[22]	No[22,23]	No[22,23]	Yes[22,24]	Yes[22]	100%
Illinois	Yes	Yes[25](3 yr)	No[26]	No[23]	Yes	74
Indiana	Yes[27](5 yr)	No	Yes[28]	Yes[24]	No[23]	97
Iowa	Yes[23,30](2 Yr)	—[31]	Yes[29](2 Yr)	Yes[32]	Yes	96
Kansas	Yes	Yes[33]	Yes	Yes	Yes[34]	95
Kentucky	Yes[35](1-2 Yr)	No[23]	—[36]	—[36]	No[23]	96
Lousiana	Yes[37]	No[38]	Yes(2 Yr)	—	Yes[39]	90
Maine	Yes[40]	Yes[40,41]	Yes[40]	—	Yes	100
Maryland	Yes (2 Yr)	Yes[33]	—	Yes[24]	Yes	81
Massachusetts	No[42]	Yes[43](3 Yr)	Yes	Yes[44]	No[45]	57
Michigan	—No[45]	Yes[46](3 Yr)	No	No	No	84

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[22] Refers to PERS.

[23] Not by statute, but in practice, yes.

[24] Information sent or distributed to employees, annually.

[25] All systems have independent audits, except Downstate Fire and Police System which is audited by State Insurance Department.

[26] No requirement for annual report, except for actuarial valuations which are reported to the Department of Insurance.

[27] Refers to the two largest systems, PERF and the teachers' fund (TRF). They are also required to have actuarial investigations. PERF prepares actuarial valuations for all other systems at its own discretion.

[28] All systems report annually to PERF, which summarizes reports to the legislature and Governor.

[29] Refers to the Iowa PERS, and the public safety system. Note required of the judicial system, by statute.

[30] The judicial system has biennial actuarial valuations as a matter of practice.

[31] Required for Iowa PERS, not specified for other systems. PERS audited by state auditor or private CPA.

[32] Reports are public information. PERS must report specifically to employees.

[33] By state auditor.

[34] Includes local police and fire charter ordinances.

[35] Kentucky Employees' Retirement System (KERS), and the state system for police and county employees (SPRS and CERS) must have annual valuations, teachers' system (KTRS) is biennial. Regular valuations not required of judicial system (JRS).

[36] KERS, CERS, and SPRS are required to issue annual reports available to the public. KTRS and JRS are not required to do so.

[37] Survey information insufficient to determine frequency, and some state systems, if not actuarially funded, may be excluded from requirement.

[38] Limited audits performed by legislative auditor's staff.

[39] By legislature's in-house actuarial staff.

[40] Refers to the Maine State Retirement System.

[41] Annual audit by state auditor, independent audits every four years.

[42] In practice, yes—every three years.

[43] By state Division of Insurance.

[44] Includes information distributed or sent to employees annually.

[45] In practice, yes.

[46] By legislative auditor.

Table 10 (continued)

STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR MAJOR STATE-ADMINISTERED SYSTEMS

(based on ACIR-NCSL survey, 1979)

48

States	Regular* Actuarial Valuation (Frequency Required, If Not Annual)	Regular* Audit (Frequency Required, If Not Annual)	Regular* Reports To State and/or Local (Frequency Required, If Not Annual)	Regular Reports Available to Employees	Fiscal Notes	EXHIBIT** Percent of Total State-Local Employees Covered by Local-Administered Systems
Minnesota	Yes[47]	Yes[46](1-3 Yr)	Yes	Yes[44]	No[45]	91%
Mississippi	Yes[48]	No[48]	Yes[48]	—	Yes[48]	99
Missouri	Yes[49]	Yes[49,50]	Yes[49,51]	Yes[49,51]	Yes[49]	75
Montana	Yes (2 Yr)	—	—	—	Yes	99
Nebraska	Yes[52]	Yes	Yes[52]	Yes	Yes	70
Nevada	Yes (2 Yr)	Yes (2 Yr)	Yes	Yes[44]	Yes	100
New Hampshire	Yes[53]	No[53,54]	Yes[53]	Yes[53,54]	Yes[53]	99
New Jersey	Yes[55]	Yes[50]	Yes	Yes	Yes	99
New Mexico	No[56,57]	Yes[57]	Yes[57]	—	Yes[57]	100
New York	Yes[58]	Yes[58,59]	Yes[58]	Yes[58]	Yes[60]	73
North Carolina	Yes[61]	Yes[62]	No[63]	No[63]	Yes	99
North Dakota	Yes[64](3 Yr)	Yes[65]	Yes	Yes[66]	Yes	96
Ohio	Yes[67](5 Yr)	No[68]	No[56]	No[56]	Yes	99
Oklahoma	Yes[69]	Yes[62,69]	Yes[69]	Yes[66,69]	Yes	89
Oregon	Yes[70](4 Yr)	Yes[62,70]	Yes[70]	Yes[66,70]	No[56,70]	95

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[47] Excluding several small state plans.
[48] Refers to the two major systems, PERS and the highway and safety patrol system (MHSPRS).
[49] Refers to the Missouri State Employees Retirement System.
[50] By state auditor.
[51] Refers to actuarial report.
[52] Refers to the five major systems administered by the Nebraska Public Employees Retirement Board.
[53] Refers to New Hampshire Retirement System.
[54] Currently undergoing first comprehensive audit, periodic audits are expected in future.
[55] Some state systems may not be required by law, but in practice, they have annual valuations.
[56] Not by statute; but in practice, yes.
[57] Refers to PERA.
[58] Refers to state employees system and state police and fire system.
[59] Annual independent audit, beginning 1980. Quinquennial audit by State Insurance Department.
[60] If requested, fiscal notes must be supplied.
[61] Refers to all systems administered by the Retirement and Health Benefits Division.
[62] By state auditor.
[63] Reports are made on specific request, except for actuarial reports which are annual. All information open to public.
[64] Annual valuations—in practice.
[65] Teacher system audited by state auditor, other are independent audits.
[66] Information sent or distributed to employees.
[67] Annual valuations are not required by statute, except for the police and fire fund (PFDPF). Experience studies, every five years, are required. In practice, annual valuations are required by board action.
[68] In practice, by state auditor once every one or two years.
[69] Refers to the two largest systems, PERS and teachers.
[70] Refers to PERS.

Table 10 (continued)

STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR MAJOR STATE-ADMINISTERED SYSTEMS

(based on ACIR-NCSL survey, 1979)

States	Regular* Actuarial Valuation (Frequency Required, If Not Annual)	Regular* Audit (Frequency Required, If Not Annual)	Regular* Reports To State and/or Local (Frequency Required, If Not Annual)	Regular Reports Available to Employees	Fiscal Notes	EXHIBIT** Percent of Total State-Local Employees Covered by Local-Administered Systems
Pennsylvania	Yes[71]	Yes[72](1-2 Yr)	Yes[73]	Yes[71]	Yes	78%
Rhode Island	Yes	—	Yes	Yes[66]	Yes[74]	87
South Carolina	Yes	No[75]	Yes	Yes[66]	Yes	99
South Dakota	Yes (2 Yr)	Yes (2 Yr)	Yes[76](2-4 Yr)	No[77,78]	Yes	97
Tennessee	Yes[79](2 Yr)	Yes[79,80]	Yes[79]	Yes[78,79]	Yes[79]	83
Texas	Yes[81]	—[82]	Yes[83]	Yes[83]	Yes	92
Utah	Yes[84](6 Yr)	—[85]	Yes	No[77]	Yes	100
Vermont	Yes	Yes[86]	Yes	—	No[77]	96
Virginia	Yes[87](2 Yr)	Yes[80,87]	Yes[87]	—	Yes[87]	85
Washington	—	—	—	—	—	94
West Virginia	Yes[88](5 Yr)	No	Yes[88]	—	Yes	98
Wisconsin	Yes[89]	Yes[89,80]	Yes[89]	Yes[89,78]	Yes[89]	90
Wyoming	Yes[90](6 Yr)	Yes[80]	Yes[91]	—	Yes	100

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[71] Refers to state employees' and public school employees' systems.

[72] Municipal system independently audited annually; state employees' and public school systems, every two years by state auditor.

[73] Refers to state employees', public school, and municipal systems.

[74] All regulations changing benefits must include funding as well.

[75] Infrequent audits.

[76] Actuarial and audit reports to legislature every two years; investment performance reports every four years.

[77] Not by statute, but in practice, yes.

[78] Information distributed or sent to employees.

[79] Refers to the Tennessee Consolidated Retirement System.

[80] By state auditor.

[81] Refers to four major statewide systems, including state employees (ERS), teachers (TRS), municipal employees (TMRS), and county and district employees (TCDRS). Judicial system excluded from requirements.

[82] ERS, TRS, and judicial systems are audited regularly, at discretion of state auditor. All other systems required to have annual independent audits.

[83] Annual reports required of all systems except judicial system.

[84] In practice, every two years.

[85] Frequency of audits unclear from survey answer. State auditor has performed audits in part. Independent audits expected next two years.

[86] By state auditor or by independent CPA.

[87] Refers to the Virginia Supplemental Retirement System—the major statewide retirement system.

[88] Refers to PERS and teachers' systems.

[89] Refers to major state retirement system.

[90] Actuarial investigations are required every two years, valuations every six years.

[91] Reports sent to legislative management council every month.

SOURCE: ACIR compilation, based on answers to ACIR-NCSL survey, Summer 1979; Source for EXHIBIT is U.S. Department of Commerce, Bureau of the Census, *1977 Census of Governments*, No. 6, No. 1: *Employee-Retirement Systems of State and Local Governments*, Washington, DC, U.S. Government Printing Office, 1978.

Table 11

STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR LOCAL ADMINISTERED SYSTEMS
(based on ACIR-NCSL survey, 1979)

States	Regular* Actuarial Valuation (Frequency Required, If Not Annual)	Regular* Audit (Frequency Required, If Not Annual)	Regular* Reports To State and/or Local (Frequency Required, If Not Annual)	Regular Reports Available to Employees	Fiscal Notes	EXHIBIT** Percent of Total State-Local Employees Covered by Local-Administered Systems
California	Yes	Yes	Yes	—[1]	Yes	22%
Florida	Yes (3 Yr)	Yes[2]	Yes[3]	Yes[4]	Yes[5]	10
Illinois	Yes	Yes	Yes[6]	No[7]	Yes	26
Indiana	No[8]	No[9]	Yes[6]	No[10]	No[7]	3
Iowa	Yes[11](5 Yr)	No	Yes[12]	—	Yes	4
Kansas	No[13]	—	Yes[14]	—	Yes[15]	5
Kentucky	Yes[16](3-5 Yr)	No[17]	Yes[18]	Yes[19]	No[20]	4
Louisiana	—	—	Yes[21](2 Yr)	—	Yes	10
Michigan	—[22]	No	—[22]	—[22]	No	16
Minnesota	Yes[23](1-4 Yr)	—[24]	Yes	Yes[25]	Yes	9
Pennsylvania	Yes[26](2-4 Yr)	—[27]	—[28]	—	Yes	22
Rhode Island	Yes	—	—	—	—	13
Tennessee	No	No	No	No	No	17
Texas	Yes (3 Yr)	Yes	Yes	Yes	Yes	8

* The frequency required by statute may not be the same as that which prevails in practice. Moreover, several states are recorded as having no statutory requirement, though in practice they have regular actuarial valuation, audits, and reports, as indicated in the footnotes. In many cases the information refers only to a subset of the total of state-administered retirement systems—though in most cases, the major state-administered systems are included. As a result of these caveats, one must be very careful in interpreting this information.

** Percent refers to all state administered systems, while survey data may pertain only to a subset of such systems.

SOURCE: ACIR compilation, based on answers to ACIR-NCSL survey, Summer 1979. Source for EXHIBIT is U.S. Department of Commerce, Bureau of the Census, *1977 Census of Governments*, No. 6, No. 1: *Employee-Retirement Systems of State and Local Governments*, Washington, DC, U.S. Government Printing Office, 1978.

Table 11 (continued)

STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR LOCAL ADMINISTERED SYSTEMS
(based on ACIR-NCSL survey, 1979)

Footnotes

[1] Annual report of finances of systems is published by state comptroller.

[2] Independent audits required from all city systems, monitored by state auditor (including special districts).

[3] Comprehensive actuarial reports required to be submitted to Department of Administration, Division of Retirement, which reports annually to the legislature.

[4] Information distributed or sent to employees, annually.

[5] Actuarial impact study prepared prior to required public hearing before any change of benefits. Full funding is also required of benefit changes.

[6] Refers to actuarial report, which is sent to Department of Insurance, Pension Division.

[7] Not by statute, but in practice, yes.

[8] All local systems report to PERF, which perform actuarial valuations at its discretion for these systems. PERF summarizes reports to State Legislature.

[9] Only the reports referred to in footnote 8.

[10] Most voluntarily supply employees with information.

[11] Refers to local police and fire systems, which must have actuarial investigations every five years.

[12] Local police and fire must report annually to city council. Quinquennial actuarial analyses reported to state commissioner of insurance.

[13] Local systems must report annually to the KPERS board (which presumably performs actuarial analyses).

[14] Local systems report to city clerk, annually.

[15] Local police and fire charter ordinances cannot be changed until there is an actuarial analysis. Fiscal notes performed by Budget Division of Department of Administration, based on information supplied by KPERS.

[16] Second class city and urban county police, fire, and civil service systems are required to have actuarial valuations every five years. Third class city police and fire—every three years; third class city civil service—required but indefinite frequency. First class city, police, and fire—no statutory requirement.

[17] The exceptions include second class city police and fire and urban county police and fire systems, which must have annual audits by "competent" accountant.

[18] Urban county and second and third class city police and fire systems report annually to county or city councils. Urban county and second class city civil service systems report to Mayor, quarterly. First class city systems—no requirement.

[19] Urban county and second class city systems must publish synopsis of report for distribution among members, or must post copies where members report. No other requirements.

[20] Not by statute, but in practice, General Assembly purchased actuarial analyses of all local proposals in 1978 session.

[21] Retirement systems supported by public funds must submit financial statements before each legislative session.

[22] Not for all local systems, possibly for county systems.

[23] First class cities have annual valuations; local police and salaried fire systems—every two years; volunteer fire systems—every four years.

[24] Most are audited, either by statute or by practice, on a regular basis, including police and fire funds which must have annual, independent audits to qualify for state aid.

[25] Synopsis required to be sent to employees.

[26] Plans with less than 50 members—every four years; plans with more than 50 members—every two years.

[27] Police and fire plans using subsidy are audited; other local systems have no such requirement.

[28] Only reports required are actuarial reports, which go to the Community Affairs Department.

Mr. CLAY. The next witnesses will consist of a panel, Alicia Munnell and Suzanne Taylor.

Without objection, your entire statements will be included in the record. You may proceed as you like.

STATEMENT OF ALICIA H. MUNNELL, VICE PRESIDENT AND ECONOMIST, FEDERAL RESERVE BANK OF BOSTON

Ms. MUNNELL. Good morning, Congressman Clay, Congressman Rangel.

I am Alicia Munnell. I am a vice president of the Federal Reserve Bank of Boston. I have worked in the area of private and public pensions for several years and served on the Massachusetts Retirement Commission which is an oversight body for Massachusetts' public pensions.

I want to make it very clear that the views I express are my own and not those of the Federal Reserve Board or Federal Reserve System.

Ten years ago Congress was in the process of enacting major legislation designed to protect employees' pension rights and to strengthen the financial status of the Nation's private pension system—an effort that culminated in the passage of the massive and exceedingly complex piece of legislation, the Employee Retirement Income Security Act of 1974 [ERISA]. Although public plans had been included in early drafts of the proposed legislation, their coverage was subsequently dropped pending the completion of an extensive study. Some of the major reasons for this decision included the dearth of information on public plans, the relative lack of complaints from public plan participants, and the concern whether the Federal Government had the power to regulate the pension plans of States and localities.

Most of the informational gaps and policy issues were addressed in the report of the congressionally mandated study, which was published in March 1978. This first comprehensive survey and analysis of public pension plans concluded that serious problems existed at all levels of Government in reporting, disclosure, fiduciary responsibility, and funding. The study also concluded that Federal regulation was necessary and desirable and that constitutional authority existed for regulating most aspects of public plans.

Today, nearly a decade after the passage of ERISA and 6 years after the publication of the congressional study, no legislation has been enacted to regulate public pension plans.

Yet, despite some improvement, many of the problems cited by the 1978 study still exist and some new ones are emerging. This is a good time to reexamine the issues confronting public pensions and to ascertain those areas where Federal legislation would be appropriate and beneficial.

In my view there are three major areas in the public pension arena that present persistent problems.

The first is the continuing lack of information for plan participants and taxpayers.

The second problem is the existence of pockets of seriously unfunded plans.

The third problem, which is a new one, is the potential adverse impact on fund performance from the emerging trend toward social investing.

All of these areas would benefit either directly or indirectly from the passage of Federal reporting, disclosure and fiduciary standards.

Let us turn first to the problem of lack of information. State and local government employees' retirement systems constitute an important component of the Nation's old age economic security mechanism. According to best estimates for 1982, they covered almost 12 million active and terminated participants, paid annual benefits of roughly $16 billon to nearly 3 million retired employees and other beneficiaries, received annual contributions from employers and employees of approximately $30 billion, and held roughly $265 billion in assets for future benefit obligations

The true dimensions of the State and local pension universe are not known, however, since no systematic procedures exist for gathering information on these plans. At the most basic level, it is unclear how many public plans exist. The 1978 congressional report cited roughly 6,000 plans, yet the annual census of governments reports on only 3,075. Beneficiary and coverage data are also unavailable on any reliable basis. Moreover, the assets of public plans are only roughly known, since many plans ignore market valuations even for marketable securities and instead show only original cost figures. While some information is available on the aforementioned characteristics of public pension plans, no data at all are generally available on the funding status of the 6,000 public pension plans. In other words, no present reporting structure exists to determine the extent to which assets are being put aside to fund current benefits.

In addition to the lack of descriptive data, benefit provisions and other information are often not provided to plan participants on a regular basis. The 1978 congressional study revealed that a substantial fraction of plans failed to disclose plan descriptions, plan amendments, statements of employee contributions or information on accrued benefits. A recent survey of the major public pension plans in New England revealed that serious deficiencies remain in the amount, format, and quality of information that some plan administrators provide to their members.

The pertinent question for those with power to regulate is whether this lack of data makes any difference to people other than academic economists. Those against regulation argue that most public employees are covered under large state systems that are generally well managed. Moreover, these groups point out that there have been no plan terminations nor flood of participant complaints as was the case with private plans and, hence, no compelling national interest that warrants Federal oversight or regulation of State and local pension plans.

On the other hand, it is difficult to understand how state and local political processes can work effectively without adequate information. A basic conflict of interest exists between the goals of elected officials and sound financial management of public plans—inadequate reporting and disclosure, particularly of cost information, allow public officials to grant generous benefit increases and shift costs to future taxpayers. Such practices can be controlled only if citizens have accurate information on the cost of benefit increases and the extent to which assets are put aside to cover future plan commitments.

For disclosure of financial information to be effective, however, taxpayers must be able to compare how their plan is doing relative to other funds of similar size. Only Federal regulation can insure that comparable and meaningful information on the Nation's numerous State and local pension plans will be reported to a central agency on a regular basis.

Underfunding in the public sector is the second major problem. Public pension plans are less well funded than private plans. Recent calculations indicate that the aggregate public plans have put aside assets to cover only 60 and 65 percent of future benefits. Aggregate data, however, mask significant variation in the degree to which various States and localities fund their plans. For example, a recent study of the major public pensions in the New England States revealed that assets as a percent of actuarial liability ranged from a high of 95 percent in New Hampshire to a low of 22 percent in Massachusetts. New England, as a whole, stands out as an area of substantial underfunding with a regional ratio of assets to actuarial liability of 27 percent compared to the roughly 70 percent ratio for the Nation.

Although pockets of substantial underfunding continue to exist, Federal imposition of ERISA-like funding standards for public plans is probably neither desirable nor feasible. First, some controversy surrounds the degree of advance funding needed for public systems, since they are supported by governments with perpetual life and the power of taxation which sharply reduced the likelihood of default. Second, a question exists whether Federal funding standards for public plans would be constitutional, since they could have a significant impact on the costs of running State government—a function that is protected by the 10th amendment.

On the other hand, some degree of funding is desirable at the State-local level to:

One. Enforce fiscal responsibility through explicit recognition of the long-term costs of proposed benefit changes;

Two. To insure that adequate revenues are available to fulfill future pension obligations;

Three. To allocate pension costs as benefits accrue so that they are financed by the generation that enjoys the services of public employees, and

Four. To strengthen the position of State and local governments in financial markets to avoid excessive interest costs as a result of low credit ratings due to large unfunded liabilities. Every argument points to at least covering so-called normal costs.

To overcome the propensity for elected officials to defer pension costs, taxpayers must have a clear idea of the current status of their pension systems and the price tags associated with proposed benefit increases. Taxpayers also need to compare their systems with ones of equal size and maturity in other States. Unfortunately, not all plans have regular actuarial valuations and when valuations are available they are not usually comparable. Not only do the actuaries employ different actuarial cost methods, but even when the same cost method is used, different economic assumptions affect the outcome. The New England study revealed that the actuarial reports for many of the individual systems were so complicated, the use of terms so ambiguous, and the assumptions so variable, that it was impossible to understand the implications of the final numbers or discern the cost impact of changes in benefit provisions. Standardization is sorely needed in the reporting of actuarial information for public pension plans and this can be accomplished only through Federal regulation.

The third problem area is the emerging interest in social investing and the potential adverse impact of that type of investing on the public pension fund's performance as people begin to recognize the potential power of the more than $1 trillion of assets in the Nation's pension plans.

Many have seen this rapidly growing fund as a mechanism for achieving socially and politically desirable objectives. While the initial debate focused on the merits of excluding companies with socially undesirable characteristics from pension portfolios, recent arguments have centered on the desirability of greater diversification of pension investments by including assets that would foster social goals, such as economic development and homeownership.

Efforts are well underway in the public sector to use State and local pension assets for the pursuit of socially oriented goals. A recent survey of the Nation's State-administered pension funds revealed that, as of June 1983, 31 States have undertaken some form of targeted or social investment. By far the most prevalent form was the purchase of publicly or privately insured mortgage-backed, pass-through securities to increase the supply of mortgage funds for homeownership. In addition, five states—Colorado, Delaware, Michigan, Ohio, and Washington—have dedicated a small portion of their portfolios for venture capital activity.

Although advocates of social investing generally contend that these goals can be achieved without sacrificing the overall return on the pension portfolio, a recent survey of the experience of public funds with privately-insured, mortgage-backed securities showed that fund managers frequently failed to exact appropriate returns on very standardized investments, in the presence of obvious benchmarks, once they focused on social considerations. Specifically, between 1980 and 1982 at least 10 States invested in privately-insured, mortgage-backed securities that were significantly riskier and less liquid than the Government-insured "Ginnie Maes" at yields that were generally below the Ginnie Mae rate.

Although this sacrifice of return could have been avoided if the managers carefully compared the risk and return characteristics of the privately insured, mortgage-backed certificates with those on comparable securities, other social investing options may be more difficult to evaluate. The most basic requirement, however, in any evaluation will be data on the current performance of the pension fund. Such information is rarely available, however, since assets are seldom reported at their market value. In the New England plans, none of the financial reports provided market value data for their assets with historical information that would provide observers with a basis for evaluating the effectiveness of their investment managers. Without Federal regulation, pension fund administrators will not provide information annually on the market value of pension assets, since they do not want to be held responsible for fluctuations in the value of those assets.

The advent of social investing also requires a clarification of the guidelines for investment decisions, so that returns are not sacrificed for the sake of social considerations. The "prudent man" standards currently applicable to administrators of private plans are far more detailed and comprehensive than the statutes governing public plans. Most States attempt to regulate pensions by a combination of constraints, those which specify a general standard of conduct and those which restrict the types of investments. The latter are generally referred to as legal lists. Because of the reliance on two criteria, the laws governing more general fiduciary responsibilities are often not specific with respect to whom the standards apply and the penalties for fiduciary misconduct. Precise standards and penalties are urgently needed as pension managers attempt to introduce social considerations into their investment decisions. This goal can most easily be accomplished through Federal regulation.

In conclusion, State and local pension plans represent an important component of the Nation's retirement system, yet inadequate information is provided to both participants and taxpayers, serious underfunding in some plans could lead to situations where legislators may have to choose between raising taxes to confiscatory limits or reneging on benefit commitments to public employees, and the advent of social investing threatens the returns earned on pension fund assets. With such a large and growing pension burden, the Nation can ill afford either benefit increases without price tags or assets that are not invested for maximum returns. However, current reporting, disclosure, and fiduciary standards cannot prevent either outcome.

Federal regulation for public pension plans would be very beneficial. Moreover, proposed Federal legislation would not materially increase the reporting and disclosure costs of State-administered pension systems. The State systems already generate mounds of paper; the legislation would not require a greater volume of material, but rather improving the quality and consolidating the information already provided. Many States could satisfy substantially equivalent requirements and gain an exemption from the Federal reporting and disclosure requirements.

The legislation could have a significant cost impact at the local level if each locally administered retirement system were forced to have an actuarial valuation every 3 years and meet the other requirements. It seems unlikely, however, that the numerous locally administered plans in States such as Connecticut, Massachusetts, or Pennsylvania will adopt this approach. Rather, the passage of PEPPRA would probably hasten the consolidation of these small plans into an expanded municipal system, following the patterns of States such as Vermont, New Hampshire, Maine, and Rhode Island. Even in the absence of Federal legislation, consolidation is a desirable development, since it could improve the portability of pension benefits, reduce administrative expenses, and enhance investment opportunities.

Despite the apparent need for good reporting and disclosure requirements, opposition to Federal standards is strong, particularly in the New England States and Texas. One important source of the opposition appears unrelated to the legislation itself. Administrators of public plans tend to link the introduction of Federal reporting and disclosure standards with mandatory Social Security coverage. Although the two proposals are totally unrelated, the perception that Federal legislation might hasten the day for universal Social Security probably explains the vehemence of the opposition in States such as Massachusetts.

Despite the opposition from plan administrators and State and local officials, the passage of Federal reporting, disclosure and fiduciary standards would benefit public employees covered by State and local pension plans as well as the taxpayers who must pay for a large portion of the costs.

I urge you to enact such legislation.

[The prepared statement follows:]

STATEMENT OF ALICIA H. MUNNELL, VICE PRESIDENT AND ECONOMIST, FEDERAL RESERVE BANK OF BOSTON [1]

THE NEED FOR FEDERAL LEGISLATION IN THE PUBLIC PENSION ARENA

Ten years ago Congress was in the process of enacting major legislation designed to protect employees' pension rights and to strengthen the financial status of the nation's private pension system—an effort that culminated in the passage of the massive and exceedingly complex piece of legislation, the Employee Retirement Income Security Act of 1974 (ERISA). Although public plans had been included in early drafts of the proposed legislation, their coverage was subsequently dropped pending the completion of an extensive study. Some of the major reasons for this decision included the dearth of information on public plans, the relative lack of complaints from public plan participants, and the concern whether the federal government had the power to regulate the pension plans of states and localities.[2]

Most of the informational gaps and policy issues were addressed in the report of the congressionally-mandated study, which was published in March 1978.[3] This first comprehensive survey and analysis of public pension plans concluded that serious problems existed at all levels of government in reporting, disclosure, fiduciary responsibility and funding. The study also concluded that federal regulation was necessary and desirable and that constitutional authority existed for regulating most aspects of public plans.

Today, nearly a decade after the passage of ERISA and six years after the publication of the congressional study, no legislation has been enacted to regulate public pension plans. Yet, despite some improvement, many of the problems cited by the 1978 study still exist and some new ones are emerging. This is a good time to reexamine the issues confronting public pensions and to ascertain those areas where federal legislation would be appropriate and beneficial. My remarks this morning will focus on the need for legislation to regulate the reporting, disclosure and fiduciary standards for public plans.

I. Why public plans need Federal regulation

The main problems in the public pension arena are the continuing lack of data, the pockets of seriously underfunded plans, and the potential adverse impact on fund performance from the emerging trend toward "social investing." All of these areas would benefit, either directly or indirectly, from the passage of federal reporting, disclosure and fiduciary standards.

Lack of information.— State and local government employee retirement systems constitute an important component of the nation's old-age economic security mechanism (see Table 1). According to best estimates for 1982, they covered almost 12 million active and terminated participants, paid annual benefits of roughly $16 billion to nearly 3 million retired employees and other beneficiaries, received annual contributions from employers and employees of approximately $30 billion, and held roughly $265 billion in assets for future benefit obligations.

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[1] The views expressed are solely those of the author and do not necessarily reflect the official position of the Federal Reserve Bank of Boston or the Federal Reserve System.

[2] For further discussion of these issues see Raymond Schmitt, "Retirement Systems of State and Local Governments—Dimensions of the Pension Problem," Library of Congress, Congressional Research Service (February 3, 1976), p. CRS-1.

[3] Pension Task Force Report on Public Employee Retirement Systems, House Committee on Education and Labor, 95 Cong., 2 sess. (GPO, March 15, 1978).

TABLE 1.—MAJOR U.S. RETIREMENT SYSTEMS, 1982

System	Benefits		Contributions		Assets (billions)
	Number of beneficiaries (millions)	Amount of payments (billions)	Number of covered workers (millions)	Amount of payments (billions)	
Social security [1]	35.4	$156.2	115.0	$145.7	$24.8
Private pensions	10.3	48.7	49.9	[2] 69.4	670.5
State and local pensions	2.9	15.7	11.6	29.9	264.2
Federal civilian retirement systems	1.9	19.2	4.6	23.8	99.5
Military retirement system	1.4	15.4	2.1		

[1] Includes disability insurance.

[2] Estimated by author assuming that, in 1982, employers made 94 percent of total contributions to private plans. Information on employer contributions ($65.2 billion) provided by the Department of Commerce.

Sources: 1983 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds (Government Printing Office, 1983), p. 68, 75; Board of Governors of the Federal Reserve System Flow of Funds Accounts, Assets and Liabilities Outstanding, 1959–82, p. 24; Survey of Current Business, July 1983, table 3.11; ICF, Inc., A Private Pension Forecasting Model, Final Report to the National Institute on Aging and the President's Commission on Pension Policy, October 1981, Department of Defense, A Contributory Retirement System for Military Personnel, 1975; and unpblished Data from the U.S. Bureau of the Census, the American Council of Life Insurance, and the Employee Benefit Research Institute.

The true dimensions of the state and local pension universe are not known, however, since no systematic procedures exist for gathering information on these plans. At the most basic level, it is unclear how many public plans exist. The 1978 congressional report cited roughly 6,000 plans, yet the annual Census of Governments reports on only 3,075. Beneficiary and coverage data are also unavailable on any reliable basis. Moreover, the assets of public plans are only roughly known, since many plans ignore market valuations even for marketable securities and instead show [illegible] original cost figures. While some information is available on the aforementioned characteristics of public pension plans, no data at all are generally available [illegible] the funding status of the 6,000 public pension plans. In other words, no present reporting structure exists to determine the extent to which assets are being put aside to fund current benefits.

In addition to the lack of descriptive data, benefit provisions and other information are often not provided to plan participants on a regular basis. The 1978 congressional study revealed that a substantial fraction of plans failed to disclose plan descriptions, plan amendments, statements of employee contributions or information on accrued benefits (see Table 2).[4] A recent survey of the major public pension plans in New England revealed that serious deficiencies remain in the amount, format, and quality of information that some plan administrators provide to their members.[5]

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[4] The Pension Task Force Report has been subject to severe criticism because of its focus on the number plans failing to meet certain standards rather than on the number of participants covered by such plans. Indeed, if data on total plans were the only information reported by the Pension Task Force, the results of the study would have been extremely misleading. The Task Force, however, avoided most of the interpretive problems associated with focusing on the number of plans rather than participants by analyzing plan practices by the size of the pension system. Such an approach reveals that even among large plans, that is, plans with 1,000 or more participants, automatic disclosure of plan information to participants was not universal.

[5] Alicia H. Munnell and Kristine M. Keefe, PEPPRA: Do New England's Public Pension Systems Need Federal Regulation?, Special Study, Federal Reserve Bank of Boston, October 1982.

TABLE 2.—DISCLOSURE BY STATE AND LOCAL PENSION PLANS: PERCENT OF PLANS PROVIDING INFORMATION TO PARTICIPANTS BY SIZE OF SYSTEM

Size of system	Percent of plans disclosing information				Total
	Never	Automatically	Upon request only	Unknown	
Participants furnished plan description:					
Large	4.5	71.5	22.4	1.6	100
Medium	15.4	65.4	18.7	.5	100
Small	23.8	40.6	27.3	8.4	100
Participants furnished plan amendments:					
Large	8.4	55.4	33.2	2.9	100
Medium	11.0	57.1	28.0	3.8	100
Small	21.0	42.7	26.6	9.8	100
Participants furnished statement of employee contributions:					
Large	2.1	81.9	13.1	2.7	100
Medium	7.0	72.1	19.8	1.8	100
Small	9.1	40.5	39.7	10.8	100
Participants furnished information on accrued benefits:					
Large	8.2	33.8	55.9	2.1	100
Medium	14.3	40.1	45.1	.5	100
Small	21.0	21.0	48.3	9.8	100

Source: Pension Task Force Report on Public Employee Retirement Systems, House Committee on Education and Labor, 95 Cong., 2 sess. (Mar. 15, 1978), table 12, pp. 211–212.

The pertinent question for those with power to regulate is whether this lack of data makes any difference to people other than academic economists. Those against regulation argue that most public employees are covered under large state systems that are generally well managed (see Table 3). Moreover, these groups point out that there have been no plan terminations nor flood of participant compaints as was the case with private plans and, hence, no compelling national interest that warrants federal oversight or regulation of state and local pension plans.[6]

TABLE 3.—DISTRIBUTION OF ACTIVE PARTICIPANTS BY SIZE OF STATE-LOCAL PENSION PLAN, 1980

System	Systems		Active members	
	Number	Percent	Number	Percent
All systems	5,788	100.0	11,157,783	100.0
Level of government:				
State-administered	554	9.6	9,372,538	84.0
Locally administered	5,234	90.4	1,785,245	16.0
Membership size:				
10,000 members or more	124	2.1	9,814,552	88.0
5,000	60	1.0	462,233	4.1
1,000	206	3.6	510,002	4.6
500	187	3.2	140,384	1.3
200	297	5.1	99,565	0.9
100	332	5.7	50,617	0.5
Less than 100 members	3,448	59.6	80,435	0.7
Unknown	1,134	19.6		

Source: Alicia H. Munnell and Kristine M. Keefe, "PEPPRA: Do New England's Public Pension Systems Need Federal Regulation?", New England Economic Review, Federal Reserve Bank of Boston, September/October 1982. Based on data from the Pension Task Force Report on Public Employee Retirement Systems, House Committee on Education and Labor, 95 Cong., 2 sess. (Mar. 15, 1978), Table F-2, p. 349 for number and distribution of systems and members in 1975. Number of active members then increased in line with the growth of the number of full-time state and local employees. U.S. Bureau of the Census, Public Employment in 1980, GE80 No. 1 (June 1981), Table 3, p. 9 and Public Employment in 1975, GE75 No. 1 (June 1976), Table 3, p. 9.

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[6] See statements in Hearings on the Public Employee Retirement Income Security Act of 1980, H.R. 6525, before the Task Force on Welfare and Pension Plans of the Subcommittee on Labor-Management Relations of the House Committee on Education and Labor, 96 Cong., 2 sess. (GPO, September 30 and October 1, 1980), pp. 461–472, 601–609, 641–652, and 1116–1132.

On the other hand, it is difficult to understand how state and local political processes can work effectively without adequate information. A basic conflict of interest exists between the goals of elected officials and sound financial management of public plans—inadequate reporting and disclosure, particularly of cost information, allow public officials to grant generous benefit increases and shift costs to future taxpayers. Such practices can be controlled only if citizens have accurate information on the cost of benefit increases and the extent to which assets are put aside to cover future plan commitments. For disclosure of financial information to be effective, however, taxpayers must be able to compare how their plan is doing relative to other funds of similar size. Only federal regulation can insure that comparable and meaningful information on the nation's numerous state and local pension plans will be reported to a central agency on a regular basis.

Underfunding in the public sector.—Public pension plans are less well funded than private plans. The Urban Institute calculated in 1980 for a sample of 100 large plans, which covered 70 percent of all participants in public plans, that the aggregate ratio of assets to actuarial liability was 79 percent.[7] Taking into account that smaller plans, not included in the sample, tend to hold relatively less assets than large plans, the ratio of assets to actuarial liability for the public pension universe as a whole is probably closer to 65–70 percent. Based on this estimate, the aggregate

TABLE 4.—PLAN ASSETS AS A PERCENT OF ACTUARIAL LIABILITY AND ACCRUED VESTED BENEFITS FOR NEW ENGLAND'S MAJOR PENSION PLANS, LATEST VALUATIONS, 1978–81

State system	Assets as a percent of	
	Actuarial liability	Accrued vested benefits
Connecticut	27.5	(1)
General employees	14.5	20.6
Teachers	36.6	51.2
Participating local districts	90.7	(1)
Maine	24.3	[3] 24.3
General employees	30.5	[3] 30.5
Teachers	[2] 8.0	[3] 8.0
Participating local districts	58.8	[3] 58.8
Massachusetts	21.9	26.6
General employees	24.9	29.3
Teachers	25.7	32.5
Participating local districts [4]	18.4	22.3
New Hampshire	95.2	100.0
General employees	95.7	100.0
Teachers	98.1	100.0
Participating local districts [5]	89.9	100.0
Rhode Island	34.5	42.5
General employees	39.2	45.8
Teachers	25.6	33.8
Participating local districts	75.6	76.7
Vermont	69.4	84.5
General employees	56.0	76.1
Teachers	85.3	91.3
Participating local districts	50.9	100.0
New England	26.7	[6] 32.7

[1] Not available.

[2] The large liability relative to assets of the Maine Teachers' System arises in large part from the inclusion in the system, as of 1947, of the "Old Teachers' System" for which no contributions were made between 1924–1945. This liability is now being met by legislative appropriation. In fiscal 1982 this appropriation totaled $12.1 million and in fiscal 1983 will total $13.2 million. The new teachers' system is being funded on the basis of normal cost plus 30-year amortization beginning in 1970. The ratio of assets to actuarial liability and to accrued benefits was 35.7 percent for the new system.

[3] Includes nonvested as well as vested benefits.

[4] Local plans are covered by state statute, but are independently administered.

[5] Systems for police and firefighters only.

[6] New England ratio excludes the one Connecticut system for which no figure was provided on accrued vested benefits.

Source: Alicia H. Munnell and Kristine M. Keefe, "PEPPRA: Do New England's Public Pension Systems Need Federal Regulation?", New England Economic Review, Federal Reserve Bank of Boston, September/October 1982.

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[7] The Urban Institute, The Future of State and Local Pensions, Final Report, mimeo (April 1981), Table 18-5, pp. 18-22.

unfunded liability for state and local plans in 1983 is roughly $100 billion, a figure somewhat below the $150-$175 billion cited in the 1978 congressional study, perhaps reflecting the trend toward increased funding in the public sector.

Aggregate data, however, mask significant variation in the degree to which various states and localities fund their plans. For example, a recent study of the major public pensions in the New England states revealed that assets as a percent of actuarial liability ranged from a high of 95 percent in New Hampshire to a low of 22 percent in Massachusetts (see Table 4). New England as a whole stands out as an area of substantial underfunding with a regional ratio of assets to actuarial liability of 27 percent compared to the roughly 70 percent ratio for the nation.

Although pockets of substantial underfunding continue to exist, federal imposition of ERISA-like funding standards for public plans is probably neither desirable nor feasible. First, some controversy surrounds the degree of advance funding needed for public systems, since they are supported by governments with perpetual life and the power of taxation which sharply reduces the likelihood of default. Second, a question exists whether federal funding standards for public plans would be constitutional, since they could have a significant impact on the costs of running state government—a function that is protected by the 10th Amendment.

On the other hand, some degree of funding is desirable at the state-local level (1) to enforce fiscal responsibility through explicit recognition of the long-term costs of proposed benefit changes; (2) to insure that adequate revenues are available to fulfill future pension obligations; (3) to allocate pension costs as benefits accrue so that they are financed by the generation that enjoys the services of public employees, and (4) to strengthen the position of state and local governments in financial markets to avoid excessive interest costs as a result of low credit ratings due to large unfunded liabilities. Every argument points to a least covering so-called "normal costs."

To overcome the propensity for elected officials to defer pension costs, taxpayers must have a clear idea of the current status of their pension systems and the price tags associated with proposed benefit increases. Taxpayers also need to compare their systems with ones of equal size and maturity in other states. Unfortunately, not all plans have regular actuarial valuations and when valuations are available they are not usually comparable. Not only do the actuaries employ different actuarial cost methods, but even when the same cost method is used different economic assumptions affect the outcome. The New England study revealed that the actuarial reports for many of the individual systems were so complicated, the use of terms so ambiguous, and the assumptions so variable, that it was impossible to understand the implications of the final numbers or discern the cost impact of changes in benefit provisions.[8] Standardization is sorely needed in the reporting of actuarial information for public pension plans and this can be accomplished only through federal regulation.

The potential impact of social investing on fund performance.—Increasing recognition of the potential economic power of the more than $1 trillion of assets held in the nation's pension plans has caused many to see this large and rapidly growing source of funds as a mechanism for achieving socially and politically desirable objectives. While the initial debate focused on the merits of excluding companies with socially undesirable characteristics from pension portfolios, recent arguments have centered on the desirability of greater diversification of pension investments by including assets that would foster social goals, such as economic development and homeownership.

Efforts are well underway in the public sector to use state and local pension assets for the pursuit of socially oriented goals. A recent survey of the nation's state-administered pension funds revealed that, as of June 1983, 31 states have undertaken some form of targeted or social investment (see Figure 1).[9] By far the most prevalent form was the purchase of publicly or privately insured mortgage-backed pass-through securities to increase the supply of mortgage funds for homeownership. In addition, five states—Colorado, Delaware, Michigan, Ohio and Washington—have dedicated a small portion of their portfolios for venture capital activity.

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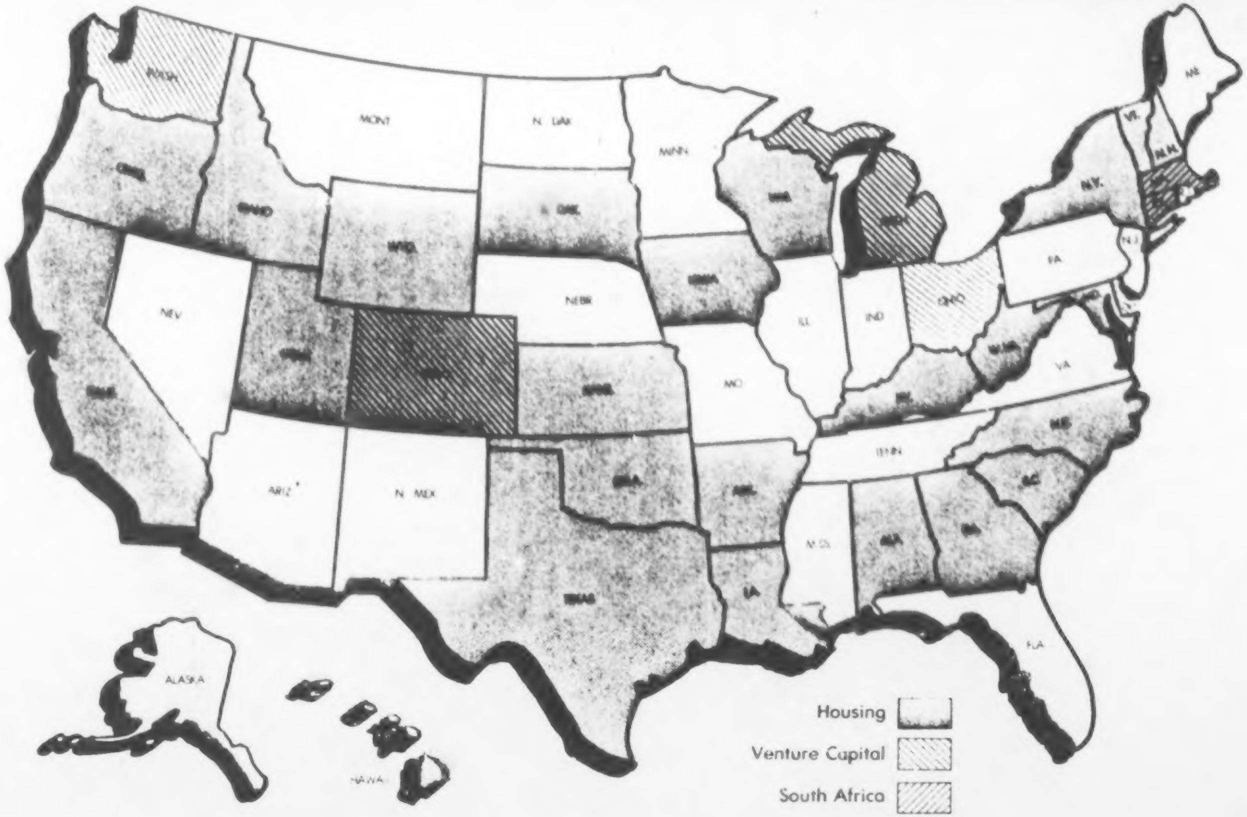
[8] Munnell and Keefe, PEPPRA, Table 5, p. 27.

[9] Alicia H. Munnell, with the assistance of Lynn E. Blais and Kristine M. Keefe, "The Pitfalls of Social Investing: The Case of Public Pension and Housing," New England Economic Review (September/October 1983), pp. 20-41.

Social Investing Among State-Administered Pension Plans, 1983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PA
N.Y.
N.J.
VT
N.H.
ME
ALASKA
HAWAII
Housing
Venture Capital
South Africa

Note: Social investing as defined by the authors includes any investment in which noneconomic considerations entered the investment decision. Under this definition, states identified as participating in social investing need not have sacrificed returns for social objectives.

Although advocates of social investing generally contend that these goals can be achieved without sacrificing the overall return on the pension portfolio, a recent survey of the experience of public funds with privately insured mortgage-backed securities showed that fund managers frequently failed to exact appropriate returns on very standardized investments, in the presence of obvious benchmarks, once they focused on social considerations. Specifically, between 1980 and 1982 at least 10 states invested in privately insured mortgage-backed securities that were significantly risker and less liquid than the government-insured "Ginnie Maes" at yields that were generally below the Ginnie Mae rate (see Table 5).

Table 5. Yields on "Maggie Maes"[a] as Compared with "Ginnie Maes" and Treasury Bonds

Commitment Date	Public Plan	Amount (millions)	Yields[b]		
			Maggie Mae	Alternative Investment	Spread
			Fixed Rate	Ginnie Mae	
10/27/80	Teachers' Retirement System of Texas	$20.7	13.57%	13.52%	+0.05%
10/31/80	Massachusetts State Employees' and Teachers' Retirement Systems	19.1	13.59	14.13	-0.54
2/26/81	Alabama State Employees' and Teachers' Retirement Systems	20.0	13.60	14.70	-1.10
3/24/81	Michigan State Employees' and Teachers' Retirement Systems	66.6	13.81	14.70	-0.89
4/ 3/81	Alabama State Employees' and Teachers' Retirement Systems	22.9	13.95	14.62	-0.67
4/24/81	South Carolina Retirement Systems	30.1	14.56	15.54	-0.98
7/16/81	Alabama State Employees' and Teachers' Retirement System	5.9	16.02	16.36	-0.34
8/11/81	New York State Employees' Retirement System	21.6	15.03	16.78	-1.75
2/ 4/82	New York State Teachers' Retirement System	28.2	16.52	17.13	-0.61
2/ 3/82	South Carolina Retirement System	24.2	14.76	17.13	-2.37
6/ 6/82	Massachusetts State Employees' and Teachers' Retirement Systems	18.0[c]	15.56	16.25	-0.69
			Fixed Rate 2nd Mortgage	Ginnie Mae	
5/22/81	Teachers' Retirement System of Texas	15.5	17.08	15.16	+1.92
11/23/81	Alabama State Employees' and Teachers' Retirement System	23.8	16.39	15.12	+1.27
2/ 4/82	Teachers' Retirement System of Texas	7.5	17.83	17.13	+0.70
			Fixed Rate 2nd Home	Ginnie Mae	
7/16/81	Alabama State Employees' and Teachers' Retirement System	d/	16.65	16.36	+0.29
			3 yr. Adjustable Rate Mortgage	3 yr. Treasury	
4/16/81	Kansas Public Employees' Retirement Fund	14.6	13.21	13.97	-0.76
10/20/81	Kansas Public Employees' Retirement Fund	32.0	16.17	15.46	+0.71
10/20/81	Kansas Public Employees' Retirement Fund	10.5	16.17	15.46	+0.71
			Early Ownership Mortgage	10 yr. Treasury	
3/26/82	Alabama State Employees' and Teachers' Retirement Systems	8.0[e]	15.82	13.88	+1.94
4/14/82	Teachers' Retirement System of Oklahoma	20.4	14.79	13.85	+0.94
7/22/82	Alabama State Employees' and Teachers' Retirement Systems	3.6	15.50	13.48	+2.02
10/23/82	Alabama State Employees' and Teachers' Retirement Systems	5.5[c]	f/	--	--
			Adjustable Balance Mortgage		
9/ 1/81	Utah State Retirement Systems	18.4	10.05	n.a.	--
10/ 5/81	Utah State Retirement Systems	32.0	10.05	n.a.	--

Source: Alicia H. Munnell with the assistance of Lynn E. Blais and Kristine M. Keefe, "The Pitfalls of Social Investing: The Case of Public Pensions and Housing," New England Economic Review, Federal Reserve Bank of Boston, September/October 1983.

[a] Maggie Maes are privately insured mortgage-backed securities issued by MGIC Mortgage Marketing Corporation, a subsidiary of MGIC Investment Corporation.

[b] Bond equivalent yield.

[c] Amount committed.

[d] Part of the $5.9 million package that included fixed rate mortgages on primary residences.

[e] Rate based on the yield on 10-year Treasuries.

Although this sacrifice of return could have been avoided if the managers carefully compared the risk and return characteristics of the privately-insured mortgage-backed certificates with those on comparable securities, other social investing options may be more difficult to evaluate. The most basic requirement, however, in any evaluation will be data on the current performance of the pension fund. Such information is rarely available, however, since assets are seldom reported at their market value. In the New England plans, none of the financial reports provided market value data for their assets with historical information that would provide observers with a basis for evaluating the effectiveness of their investment managers. Without federal regulation, pension fund administrators will not provide information annually on the market value of pension assets, since they do not want to be held responsible for fluctuations in the value of those assets.

The advent of social investing also requires a clarification of the guidelines for investment decisions, so that returns are not sacrificed for the sake of social considerations. The "prudent man" standards currently applicable to administrators of private plans are far more detailed and comprehensive than the statutes governing public plans. Most states attempt to regulate pensions by a combination of constraints, those which specify a general standard of conduct and those which restrict the types of investments (see Table 6). The latter are generally referred to as "legal lists." Because of the reliance on two criteria, the laws governing more general fiduciary responsibilities are often not specific with respect to whom the standards apply and the penalties for fiduciary misconduct. Precise standards and penalties are urgently needed as pension managers attempt to introduce social considerations into their investment decisions. This goal can most easily be accomplished through federal regulation.

Table 6.—Legal limitations on pension fund investments, 1983

PRUDENT MAN ONLY—6 STATES

Delaware
Idaho
Maine
Indiana teachers retirement system
Nevada
South Dakota

PRUDENT MAN WITH RESTRICTIONS—31 STATES

Alaska
Arizona
Arkansas
California
Colorado
Connecticut
Hawaii
Illinois
Indiana Public Employees
Kansas
Kentucky
Massachusetts
Michigan
Minnesota
Mississippi
Missouri
Nebraska
New Hampshire
New Jersey
New Mexico
New York
Ohio
Oregon
Pennsylvania
Rhode Island
Texas
Utah
Vermont
Virginia
Washington
West Virginia

LEGAL LISTS ONLY—13 STATES

Alabama
Florida
Georgia
Iowa
Louisiana
Maryland
Montana
North Carolina
North Dakota
Oklahoma
South Carolina
Tennessee
Wisconsin

NO STATUTORY RESTRICTIONS—1 STATE

Wyoming

Source: Alicia H. Munnell, with the assistance of Lynn E. Blais and Kristine M. Keefe, "The Pitfalls of Social Investing: The Case of Public Pensions and Housing," New England Economic Review, Federal Reserve Bank of Boston, September/October 1983. Based on authors' survey of state-administered pension funds and The Pension Task Force Report on Public Employee Retirement Systems, Committee on Education and Labor, 95 Congress, 2 session (GPO, March 15, 1978), pp. 445–471.

II. Conclusion

State and local pension plans represent an important component of the nation's retirement system, yet inadquate information is provided to both participants and taxpayers, serious underfunding in some plans could lead to situations where legislators may have to choose between raising taxes to confiscatory limits or reneging on benefit commitments to public employees, and the advent of social investing threatens the returns earned on pension fund assets. With such a large and growing pension burden, the nation can ill afford either benefit increases without price tags or assets that are not invested for maximum returns. However, current reporting, disclosure, and fiduciary standards can not prevent either outcome. Federal regulation for public pension plans would be very beneficial.

Moreover, proposed federal legislation would not materially increase the reporting and disclosure costs of state-administered pension systems. The state systems already generate mounds of paper; the legislation would not require a greater volume of material but rather improving the quality and consolidating the information already provided. Many states could satisfy "substantially equivalent" requirements and gain an exemption from the federal reporting and disclosure requirements.[10]

The legislation could have a significant cost impact at the local level if each locally administered retirement system were forced to have an actuarial valuation every three years and meet the other requirements. it seems unlikely, however, that the numerous locally administered plans in states such as Connecticut, Massachusetts or Pennsylvania will adopt this approach. Rather, the passage of PEPPRA would probably hasten the consolidation of these small plans into an expanded municipal system, following the patterns of states such as Vermont, New Hampshire, Maine and Rhode Island. Even in the absence of federal legislation, consolidation is a desirable development, since it could improve the portability of pension benefits, reduce administrative expenses, and enhance investment opportunities.

Despite the apparent need for good reporting and disclosure requirements, opposition to federal standards is strong, particularly in the New England states. One important source of the opposition appears unrelated to the legislation itself. Administrators of public plans tend to link the introduction of federal reporting and disclosure standards with mandatory social security coverage. Although the two proposals are totally unrelated, the perception that federal legislation might hasten the day for universal social security probably explains the vehemence of the opposition in states such as Massachusetts.

Despite the opposition from plan administrators and state and local officials, the passage of federal reporting, disclosure and fiduciary standards would benefit public employees covered by state and local pension plans as well as the taxpayers who must pay a large portion of the costs.

I urge you to enact such legislation.

Mr. Clay. Thank you.

Ms. Taylor.

STATEMENT OF SUZANNE TAYLOR, PH. D., COORDINATOR OF RESEARCH, CONNECTICUT EDUCATION ASSOCIATION

Ms. Taylor. Thank you for inviting me.

I am sorry Congressman Erlenborn is not here because I testified way back in pre-ERISA days why the public employees should be separated from coverage under that legislation.

Nonetheless, I would like to thank him for his efforts. Pending ERISA type legislation has given me much opportunity to continue to study the problems of the public sector.

I would like to introduce myself a bit further. I work for the Connecticut Education Association, and I have been on a sabbatical leave conducting research for the Pension Research Council at the

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[10] Both bills introduced in 1982 to regulate public plans included a feature that allowed an exemption from the federal reporting and disclosure requirements for plans in states with substantially equivalent requirements. To gain this exemption, the governor of a state must certify to the Secretary of Labor that not only is the state law substantially equivalent, but that the state can administer the law adequately and will collect the annual reports required under its law and provide them to the Secretary of Labor.

University of Pennsylvania, Wharton School. It is this research on which I have been asked to testify about and explain to you.

It occurs to me I am one of the few who has been looking, with some objectivity, as to what is going on around the country in public pensions. The book in process, which I am writing, will be published this summer and called "Governance and Financing of Teacher Retirement."

In addition to teachers these systems sometimes include municipal employees, and sometimes all sorts of other State government workers because the systems are often under one manager. Therefore, while I chose to segregate basically teacher retirement systems, I was also given a bird's eye view of what exists in the entire United States, Puerto Rico, and the District of Columbia.

I did not go to Samoa, although I was doing phenomenological research similar to that done by Margaret Mead as somehow pensions are not yet coming of age in Samoa. Nor did I go to Hawaii or Alaska, but I did travel to 25 other States.

Mr. CLAY. Did you go to the island of Grenada?

Ms. TAYLOR. No; my remarks may be more informal than those of Alicia Munnell's, due to the short notice, as your counsel Phyllis Borzi heard me speak in Phoenix last week and suggested I share some of this information with you.

There are many States who are not reporting and disclosing information and who are not doing what they should. I want to offer you some reasons as to why that is occurring.

I think there appears to be a correlation between the independence of the structural organization of the public employee's system and their ability to provide adequate information on which to judge the merits and fiscal soundness of the system.

In fact, I thought it would be of interest to note that the most recent publication of the Illinois Public Pension Law Commission which is working and struggling with oversight responsibilities has a contradictory statement in it, which says:

> The Commission believes that, as a the first step in achieving adequate funding, meaningful and complete disclosure is required of the funding requirements and the financial position of retirement systems. Interested parties, such as government officials, taxpayers, and members of the systems should be able to assess the true financial condition of a public retirement systems. It should be possible to determine whether the current financing arrangements are sufficient to meet the funding requirements of the system or whether the system is incurring hidden debts which will be passed on to future generations of taxpayers. (p. 41 Report of the Illinois Public Employees Pension Law Commission 1981–83.)

It also says on page 42:

> A number of retirement systems do provide substantially all the information necessary to adequately disclose the financial position of a retirement system. But in some cases, even though all the necessary information is disclosed in the annual reports, these annual reports are not publicly available. Thus, interested parties may not be able to assess the financial position of the retirement system even though the necessary information is available.

In one instance the State of Washington sent me their only copy of an annual report. It took 3 weeks to come across the country.

In Illinois, itself, while the teacher's system has an annual report, much needed information is missing, and I brought copies with me—this is their annual report. Moreover, in collecting actuarial valuations from systems all over the country, only Illinois had none in writing, although it paid $40,000 for it. There are abbreviated notes in the annual report, put there at the insistance of the executive director. I commend Illinois for working harder to try to get better figures on what is going on. As one of the largest pension systems in the country, it is a poor example of disclosure on funding adequacy.

Yet the report of the Illinois Pension Law Commission says they don't want Federal legislation to mandate disclosure because they will get it themselves, but they have not passed it through the legislature yet. They seem to say thank you for threatening them with Federal regulations, so it might be easier to pass State laws, but they have not done it yet.

I would say that Illinois is definitely an exception on terms of actuarial valuation. Although other systems did not provide adequate information, they did have actuarial valuations which I was able to look at.

Before I give you a quick summary of who did what, I would like to share with you the system's organizational structure which I think makes a difference.

I had asked earlier for an outline (see attached) that I brought with me to be reproduced for you. I will refer to that in the following. Basically there are three classifications of systems in the government structure.

One has corporate characteristics and one has government characteristics, with many systems somewhere in between. I won't belabor the point of what the characteristics are except to say in general there are some systems in this country that act like private corporations.

Many of the systems in this country are really government agencies subject to all the usual bureaucratic strangulations and deprivations associated with a lack of funds.

The five corporate systems which I identified in my study, are Colorado, Ohio, Alabama, New York State, and Texas. These systems virtually decide how thay will spend their money, with few government controls. Therefore, in general, they do a very good job of reporting and disclosure.

We also have, some examples of their reports and you will hear from Texas, itself, telling you what a good model Texas can be.

There are also quasi-corporate systems, such as California, Illinois, and Pennsylvania.

Pennsylvania's school employees system is a good example of adequate disclosure as you can see by its reports.

There is a booklet that shows employees what their benefits are; it is updated. There is sufficient counseling given to them. There is an annual report. Also it is published in sufficient quantities that people can have it if they need it.

California also publishes an excellent annual report. It is in very limited quantities and, in fact, their director told me that the legislators have told him not to send them copies unless they request it.

There is definitely a serious problem in California which you alluded to earlier and they do not have the wherewithal to implement the responsibility that they have been given.

Mr. CLAY. For the record, can you tell me the exact amount of money that was missing or improperly invested? I thought I remembered reading $100 million.

Ms. TAYLOR. I thought you were about accurate, but it was half that amount, $50 million.

By the way, California does have its own fiduciary standard. It is perfectly possible that the board members will be liable and will be sued for concurring with the recommendations of the subcommittee that made the recommendation to invest that money in that way, against the wishes of the staff.

Mr. CLAY. Thank you.

Ms. TAYLOR. There are then mid-corporate-government systems—Maryland, which some of you may know about, New Mexico, and Arizona.

Maryland is a very new structure which keeps changing its mind on how it ought to be organized. In the beginning I thought it might be a structure worth looking at as a model of equal balance, but it changes so rapidly, there is not time to study the effects of the organization.

Maryland separates the investment responsibility from the administration responsibility but in that manner still retains one board with responsibilities and control for both functions.

In all of these pension systems that I have talked about so far the investment responsibility and administration of the employees' benefits are under the same board.

With the government agency format they are separate and that makes things much more difficult because of dealing with two or three different agencies, usually one for administration and one for investments.

By the time you get to the States of North Carolina, Virginia, and Tennessee, we find out that these are like the public corporations, but they in fact function like government agencies because the State treasurers, in general, have very strong control over how these systems will be run.

In the government systems it is interesting that in three of them the State is the trustee. In the instances of all the others there is a board of trustees with some degree of representation by beneficiaries or participants on the board.

In general where there are plan participants or beneficiaries as trustees, they are in the public corporation type sector. The further down you go toward it being a government agency, the less you get representation on the board by the employees.

Florida is unique in that it does not have a board of trustees for the administration function, but it has a board of trustees overseeing the investment operation, which is Government. Florida, by the way, in the area of disclosure in terms of its administration has an adequate package of information. It is "Everything You Might Want To Know And More" about Florida's pensions for teachers, State employees, and municipal workers.

Not everyone in Florida is pleased with the system as it is, but if they read all the available literature, they will know what is going on.

In terms of South Carolina, they also separate administration from investments and do not have trustees other than a board of control which is made up of the Governor, controllers, and three other elected State officials. Again, they invest basically in bonds.

In terms of reading what is happening in benefit administration, you have to look at a different report than the ones that tell the employees what is happening to their money.

Washington State did not make a required payment of over $200 million for 2 years into their pension fund. This past June 30 it did make the payment with interest, due to some pressure by employee groups, I feel.

It has issued a new report on its investment structure "the first annual" because what it has done is abolish the employee participation in the administration angle and started putting them on the investment board.

They have also required five investment experts to serve on the 15-member council, which will make investment decisions for the State of Washington. However, how often that committee exercises its authority will actually depend on the people who monitor it and the availability of periodic reports.

Washington, by the way, is one of only three States which have a State actuary, New York City, New York State, and Florida also have in-house actuaries, although Florida also uses an outside actuarial firm. Otherwise, external actuaries are utilized by the remaining States.

The three midwestern States, Minnesota, Wisconsin, and Michigan—you asked about Michigan—do not have adequate reporting, to my thinking.

There really is not that much to bring you in terms of what is available. There is more in the investment area than there is in the benefits area and employees would have some difficulty knowing what their rights are.

Re Michigan, as you asked, why didn't that oversight type commission get funded? As I understand it from Congressman Spaniola, it was viewed as retribution to him personally for his involvement in some other pension activities that were occurring, which displeased his colleagues—Representative Spaniola is and has been chair of the Michigan State House Pension Committee.

However, I understand now there is a movement afoot in the current legislature to fund the study commission and to extend its life.

Certainly it would appear that more disclosure is needed in Michigan and in the northeastern States of Connecticut, New Jersey, and Massachusetts. The last three are perhaps the worst examples of disclosure and reporting, I have found.

One of the things I would like to say is where you have a revenue-dispersing agency which is the agency that is used for disbursing employee benefits, and thus responsible to provide the annual statement, the Government does not like to spend money to give away money, so less care is given to doing an adequate job for employees.

The Government, however, will spend money to make money. In general, investment overseeing is better run than is the revenue-dispersing side of the agencies. There is great need for much more help and assistance in New Jersey.

New Jersey's plan description for employees looks like this. It was last published in 1973. Certainly it would not comply with ERISA. Instead the New Jersey Education Association publishes an explanation of what happens to the teachers pensions. The annual reports are typewritten and mimeographed, but not sufficiently detailed, and distributed in very limited quantities.

In Massachusetts I have been waiting 2 years to get a copy of the annual report, because there is no money to publish the annual report.

I can give you an example of Connecticut, my own State, whose report is also a mimeographed one furnished to the Government. It is the most incomplete report I have seen anywhere. Again, investment information is separate from the revenue disbursing function in Connecticut, with much more comprehensive investment data available.

I am going through this very fast. If you have some questions, I will be glad to answer them or I will be glad to make further information available.

I want to conclude with the fact that when I ask what does all this mean in terms of structure, it means that funding is the most serious problem for everyone, and without that disclosure it is difficult to know how serious the problem is. Illinois is the best and worst example.

In terms of adequacy of benefits and needs of members and what is happening to the investments, the way in which, again, all these are approached really ought to be looked at through the structure and I have developed a chart on this.

In some instances, for example, legislators themselves serve on the board of trustees and vote. The only State I know of in the country where this exists is Pennsylvania. Legislators actually vote, only on the board of trustees of the State employees, and although they sit on the school employees board, they may not vote on that board.

Clearly we are talking about a different situation where legislators are involved with what happens to both State and local pension systems.

I should like to point out there are several large city systems for teachers, including New York City, Denver, Chicago, and Washington, D.C.

The D.C. pension plan is unique in that there are three separate governments involved. The complexity of regulating it is overwhelming.

It seems to me the basic thing you are asking for, the provision of information is not impossible to achieve and certainly is much needed for everyone to know what is really happening in the public sector with their money. It is not only taxpayers' money, but Members' money as well.

Thank you.

Mr. Clay. I would like to thank both of you for confining your remarks to the subject matter on which the committee is holding hearings and not diverting it to a debate about Federal employee pensions.

I also serve on the Post Office and Civil Service Committee. For a while I thought I was in a Post Office and Civil Service hearing when our last witness and some of the Members of Congress got through discussing pros and cons of the Federal employee plan.

Let me ask you, you say it was your opinion that taxpayers and public employees would benefit if PEPPRA were enacted.

Would you elaborate on that?

Ms. MUNNELL. We did a study for the New England States. I have to tell you my notion before I started was that probably the New England States satisfied all the requirements of PEPPRA already.

I was wrong; they did not. In Massachusetts it is impossible to get a copy of the financial report. We had to go and Xerox it for $47.60. That was the cost of the report for the State system alone.

For the State and teacher's systems you have to really negotiate to get the actuarial valuation that was done for 1979. Even the plan descriptions were not kept up to date. Plan amendments were not provided on a regular basis.

In areas where you have serious underfunding you will not get any action until people are familiar with how pensions are financed. There is no way to get information on the status until information is provided generally and this will not be done without Federal regulation.

Mr. CLAY. It is your opinion there is still considerable heel dragging among the States?

Ms. MUNNELL. There definitely is. It has been documented. They have not done the job they are required to do.

Mr. CLAY. Will you elaborate further on the statement you made about some of the reasons why local officials, State officials, are opposed to this legislation?

Ms. MUNNELL. My views on the reasons for opposition are derived mainly from conversations and conjecture. I think that one of the components of PEPPRA that causes the most discomfort among plan administrators is the requirement to publish assets and market value every year. Once that is done people are going to look at that number and ask what happened from last year and somebody is going to have to answer.

Currently it is impossible to find out how the pension funds are performing in many of the New England States; no one is asking how that money is invested and how well it is doing.

Given we are entering the era of social investing where the decisions are becoming even more complex, you certainly want the taxpayers to have access to information they can evaluate as to what is being done with their tax dollar.

Mr. CLAY. In terms of social investment, you would not be opposed to it if you could reap the same amount of earnings in terms of investing in housing and other developments?

Ms. MUNNELL. I am not against good things.

Mr. CLAY. As opposed to investing it in casinos?

Ms. MUNNELL. That would be fine. The study we just completed showed that once plan administrators take their eye off the mark, which is maximum return, that they tend to make mistakes. If social investing is going to be done, it has to be done carefully and has to be carefully structured so that the pension plan will not forfeit earnings.

Mr. CLAY. Thank you.

Mr. Rangel.

Mr. **Rangel**. Let me congratulate you for doing such a thorough research job which almost flies in the face of some unpopular political views.

I hope you share that with my colleague in Government who is still with us because obviously they have taken a position, but perhaps the data you have accumulated has not been available to them.

Having said that, I would welcome the opportunity to have the representative of these State associations come back before the committee once he has had access to the information that both of you have so adequately provided to us this morning.

Has either one of you had an opportunity to review the responsibility under existing law, of how our tax laws relate to public pension funds?

Ms. **Munnell**. No, I have not.

Mr. **Rangel**. Obviously there is not too much enforcement because the sanctions are against employees since the governments really don't enjoy tax exemptions. They already have it as an entity.

What branch of government do you believe should provide the oversight in protecting the investment of pension funds, reporting and disclosure?

Ms. **Munnell**. I think it has to be done at the Federal level because it is not going to be done at the State level.

Ms. **Taylor**. I would say if you wish to have a plan whereby you get better tax benefits for your employees, write and get a letter of qualification from IRS. It seems to be not difficult to get a letter of qualification.

In the private sector it is much more difficult to get a letter of qualification to qualify a plan in the private sector.

I would hope you would go further to find out if it is actually true or not.

Mr. **Rangel**. The IRS is reluctant to enforce existing law where the penalty falls merely on the employee through no fault of their own from mismanagement and, of course, the Government entities would not be adversely affected.

If we did have legislation and clearly saw a violation of the rules of nonperformance of responsibility, what penalty would either one of you suggest as relates to tax exemption where already the public entity is immune?

Ms. **Munnell**. I think that is not the way to go. PEPPRA has some provisions for suit and civil fines for not satisfying requirements of ERISA on reporting and disclosure. That seems to be the way to handle violations of that type.

Ms. **Taylor**. I think I would concur at this point. It is very, very difficult to penalize government if they are nonprofit organizations. If they are profit organizations, that is a different matter.

On the other hand, if it becomes public knowledge that government is not obeying Federal law, I don't know, I would like to see what happens in the court.

I would be interested to discuss it further.

Mr. RANGEL. I was very serious in my recommendation and I hope that Representative Townsend recognizes the spirit in which I have made it.

I am going to ask staff to make the testimony available to him and we will keep the record open in not only fairness, but in order to make certain we have a full record for your response to the information as relates to unfunded State plans.

Mr. CLAY. Mr. Bartlett.

Mr. BARTLETT. Thank you, Mr. Chairman.

I concur with the chairman of the Ways and Means Subcommittee. We ought to leave the record open. I do believe the subcommittee needs to know with some additional precision what States have made progress, what States are providing reporting procedures to their participants, and some of the questions raised here.

I think that would be very helpful.

On page 3, Ms. Munnell, I am a little unclear, about the top paragraph as to what you mean. You state that: "No present reporting structure exists to determine the extent to which assets are being put aside to fund current benefits."

I suppose you are concerned that no reporting structure exists that is a national compilation or do you contend that most plans have no reporting structure to determine the extent that assets are being accumulated?

Ms. MUNNELL. Those plans do have actuarial valuation, but not necessarily every 3 years. There is no way to have it compiled in a single area or document so that one can look over at what is happening in the State and local areas. There is no national compilation. The only way to get information is to contact every single plan and get their actual valuation.

Mr. BARTLETT. My question is, can you define for us what national interest would be served by national compilation?

I clearly understand what interest is served by employees to have a reporting of the assets of his or her own plan, but in terms of the national compilation, will you define the national interest that is required for such compilation?

Ms. MUNNELL. The degree to which pensions are funded has an impact on national savings and capital accumulation which is something everyone is interested in and that type of analysis can only be done when you have accurate information on what is going on in the whole public pension arena.

Mr. BARTLETT. You specified three different areas where you think there are problems with local plans right now, lack of information at the national compilation level and also lack of information submitted for individual employees, underfunded plans, and social investing.

Would you propose that this legislation solve all three problems or would you limit it only to the lack of information?

Ms. MUNNELL. My comments were not designed to indicate that the legislation can solve all three problems. I think the proposed legislation would have the beneficial impact on all three areas. It would not eliminate problems. You cannot eliminate funding problems with disclosure and reporting, but it would help move taxpayers in that direction.

Mr. **Bartlett**. Do the two of you find the phenomenon of unwise social investing—by unwise, I mean social investing that does not obtain comparable return—do you find that an increasing or decreasing phenomenon in the last 2 or 3 years?

It was a rather novel experiment, I understand, 10 years ago.

Do you find that social investing without comparable return to be increasing?

Ms. **Munnell**. This is where there is very, very little information available. We did a survey of the State-administered plans this summer and that was the first comprehensive survey of social practices.

The survey revealed not that plan administrators always sacrifice returns for social considerations, but it is possible to document particular types of securities that they purchase at rates that were not comparable in terms of the liquidity and risk characteristics of the security.

Mr. **Bartlett**. For example, Mr. Woodruff asked me if in the morning paper I noted that taxpayers of California could save hundreds of millions of dollars per year by increasing the return of pension portfolios to reasonable levels.

I am not familiar with what the taxpayers of California are going to do about that now that they have the knowledge, compliments of the Washington Post.

Ms. **Munnell**. I think Mr. Woodruff is here.

Mr. **Bartlett**. Do you know what the phenomenon is in California? Do you believe California taxpayers will take note of hundreds of millions of dollars of hemorrhage in the fund.

Ms. **Munnell**. I am not familiar with the investment practices in California.

Ms. **Taylor**. Could I suggest that a similar problem occurred in Texas. It is hard to predict what taxpayers will do, but if Texas had funded $200 million that they decided to cut back from the funding of the system for the next 2 years, you would have earned more money and had more to invest and, therefore, saved the taxpayers money.

It is a difficult concept to push, but if you spend more money, you will have made more money from investment earnings.

In general, taxpayers don't want to pay taxes. Instead of social investing being the most difficult problem right now, it is government trying to borrow pension funds to use to balance their budget or to lower payments to the funds to keep taxes down now.

That is the trend I see around the country, or not putting the money up and not understanding that they ought to have the present generation pay for the present generation's salaries.

I would suggest that PEPPRA ought to be stronger and have some stronger funding standards in it.

Mr. **Bartlett**. As I understand it, Texas did have some serious problems and took action, in essence, as I understand it, to comply with what that legislation would require.

I am trying to get a handle on how many States—I am not certain there is contradiction between your two testimonies—how many States would be exempt from this legislation? That is to say, how many States are already complying with the legislation of reporting and disclosure?

I hear on the one hand almost everyone is already complying and on the other hand, no one is.

If we were to adopt this, how many States would be exempt or at least exempt with only a modest change?

Ms. MUNNELL. I did a detailed study comparing provisions of PEPPRA with what goes on in the New England States. None of the New England States would be exempt.

Ms. TAYLOR. That is correct. Futher, on my research, in 30 other States approximately half of those States would not be exempt.

There are a substantial number of States that would still be affected and could benefit by having legislation that would force them to report and disclose in an orderly and conventional fashion.

Mr. BARTLETT. So, the statement on top of page 9 that:

"Many States could satisfy 'substantially equivalent' requirements and gain an exemption from the Federal reporting and disclosure requirements."

That means many States would satisfy it now or could satisfy it easily?

I guess I am not clear as to how difficult it would be for States to satisfy the requirements of the disclosure requirements.

Ms. MUNNELL. Some States would require substantial, effort. Some like Maine, would be relatively easy to bring up to speed.

Connecticut is mind-boggling. We could not even find the number of local plans. There are supposed to be 155, plans, but nobody has a list of them. The division could only provide a list of the 459 towns and municipalities with asterisks by the 727, towns that belong to the municipal system. The only way to find out whether the remaining entities have their own pension plan is call each town.

Mr. BARTLETT. It would be a substantial burden for the States to comply with this legislation?

Ms. MUNNELL. They should do it.

Mr. BARTLETT. I understand it. I am trying to understand what impact it would have.

Ms. MUNNELL. It varies.

Ms. TAYLOR. I think you ought to realize that you are affecting municipal legislation as well as State legislation. The State plans probably cover the largest percentage of the employees you are talking about.

Of those States, I would venture a third could easily qualify with what they are doing now. The rest would have a great deal of difficulty, but could do it without a loss of money because they are already doing it.

They are not making much of the documentation available, but somebody knows what is happening. It is just the rest of the world does not know what is happening.

Mr. BARTLETT. So approximately one-third is complying?

Ms. TAYLOR. States. Not municipalities.

Mr. BARTLETT. Would you require the "prudent man" rule to be implemented?

Ms. MUNNELL. I think this is a good idea.

Mr. CLAY. Mr. Pickle.

Mr. PICKLE. Mr. Chairman, what is the chair's plans with respect to time?

Are you going to try to continue this afternoon?

Mr. Clay. Yes, we have invited a number of witnesses. I would like to be out of here by 1 o'clock, if possible.

Mr. Pickle. That is a goal to be desired, Mr. Chairman.

Ms. Munnell, you submit that some 10 States had invested in private insured mortgage investments riskier than government-insured "Ginnie Maes." Then you give a chart to show the type of investment.

Is this a finding of fact by a panel or by your research? Where do you get that information?

Ms. Munnell. Please don't blame it on the Federal Reserve System. It was on research we did by contacting the individual plan administrators.

Mr. Pickle. In the various States?

Ms. Munnell. In the various States. Speaking to them directly and doing sort of a "deep throat" kind of activity with MGIC Marketing Corp., sending them data saying is there any incorrect information on this sheet? They circle some incorrect information and we deleted that material from the study.

Mr. Pickle. Has the Federal Reserve in Boston asked that this information be compiled?

Have you done this on your own?

Ms. Munnell. I did it on my own.

Mr. Pickle. You are with the Federal Reserve of Boston. Are you speaking for them or just yourself?

Ms. Munnell. I was very careful when I introduced my remarks——

Mr. Pickle. I would hope if you have information, data, statistics that show some of these States have invested in mortgages riskier than Ginnie Mae, that this information be turned over to the Federal Government.

Has the Federal Government expressed any interest or have you reported this?

Ms. Munnell. It is in an article that came out in a recent Federal Reserve Bank bulletin.

Mr. Pickle. Mr. Erlenborn and I probably had more to do with the Federal Government granting the right to make investments in these mortgages than any two Members of Congress. And both of us took a lead on ERISA 10 years ago. Since then, I have been very active in pension investigation.

I was glad to see the administration allow the investment of these funds in the housing area.

If it is not being administered properly, I think that ought to be reported. I think the administration would want to look into it very carefully.

I had not heard there was any question about poor investment. If there is poor investment policy, I think you ought to report that.

Ms. Munnell. There is nothing intrinsically wrong with the investments. It is that managers were not diligent in extracting a market return.

Mr. Pickle. The inference is that poor investment is due to State control.

I question that inference.

Ms. Munnell. I do, too.

Mr. CLAY. We certainly want to thank you for your testimony.

The next witnesses scheduled are from the Internal Revenue Service, but Congressman Rangel has requested that he be here when you give your testimony, Mr. Winborne. So, we will go on to the next panel, Gerald W. McEntee, John J. Sweeney, Linda Tarr-Whelan, and Harold Schaitberger.

STATEMENT OF GERALD W. McENTEE, PRESIDENT, AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, AFL-CIO, ACCOMPANIED BY CHARLES M. LOVELESS, LEGISLATIVE REPRESENTATIVE AND WILLIAM B. WELSH, DIRECTOR, DEPARTMENT OF LEGISLATION

Mr. McENTEE. Good morning, Chairman Clay and distinguished members of the Subcommittees on Oversight and Labor Management Relations.

We appreciate the opportunity to present the views of AFSCME, the American Federation of State, County and Municipal Employees.

I am Gerald W. McEntee, president of AFSCME.

We appreciate the fact that our written statement will be in the record.

I would also like to note that included with our written statement is a copy of an independent study on State and local pension plans which, incidentally, was released yesterday.

The study, entitled "Dollars and Cents: The Case for State and Local Pension Reform," was commissioned by AFSCME and prepared by Thomas Woodruff, former Executive Director of the President's Commission on Pension Policy.

We believe the study is of such paramount public interest that we are sending a copy of it to each and every member of Congress. In our view, it graphically documents the scope of the crisis confronting state and local government retirement systems.

Chairman Clay and Chairman Rangel, we commend you and the other members of the subcommittees for holding these hearings because they focus on a serious and troublesome problem.

The exhaustive report of the House Education and Labor Committee's task force on public pension plans, the report by the General Accounting Office, the new Woodruff study and the reports of numerous other Government and private studies all underscore one essential fact: Our State and local public employee retirement systems face a major crisis.

More than the fiscal stability of these plans is at stake. The problems afflicting these plans threaten as well the many people who depend on them for their current or future economic security.

And, as you are well aware, the problems are of such magnitude that they threaten the basic fiscal integrity of State and local governments. We believe that certain conclusions are inescapable.

Many public pension systems are dangerously underfunded. There is no comprehensive and uniform set of principles that adequately safeguard the operation of State and local plans. Fiduciary protections are most often inadequate.

Meaningful standards for reporting and disclosure are notable by their absence. Until this time the Federal Government has done little to protect the millions of participants who are affected.

I want to point out that unlike their brothers and sisters in the private sector who are protected by ERISA, State and local government workers have virtually no Federal protection for their retirement income.

It seems to me a commonsense proposition that the assets of any pension plan belong to its participants, that the assets should be invested for the exclusive benefit of the plan participants and beneficiaries and that individuals who control those assets should be held under law to a high standard of behavior.

In fact, all this is the case in the private sector. Unfortunately, it is by no means a settled proposition in the public sector. Conflicting and ambiguous State and local laws and court decisions have created much uncertainty about the legal rights of participants in public pension plans.

As a constructive means of addressing the public pension crisis, the union I represent strongly supports the enactment of minimum Federal reporting, disclosure and fiduciary standards and public sector tax qualification requirements for State and local government retirement systems.

This type of legislation was known in the past Congress as PEPPRA, the Public Employee Pension Plan and Reporting and Accountability Act, which was reported out of the Education and Labor Committee.

In our view, PEPPRA type legislation does not constitute a radical approach to resolving the fundamental problems that threaten State and local government pension plans.

It carefully limits the degree of Federal instruction to State and local affairs by giving the States responsibility for administration and enforcement of certain of PEPPRA's provisions.

It does not constitute nor should it constitute a whole extension of ERISA to public plans. Instead it recognizes the unique characteristics of such plans.

We also want to emphasize that the PEPPRA legislation does not mandate the existence of a State or local plan. Neither does it mandate the level of benefits to be provided.

What it does do is attempt to provide some practical assurances that the benefits promised under a voluntarily adopted plan are in fact secure.

We believe it is a bill which clearly is in the interest not only of participants and beneficiaries, but also of the public at large because that public has every right to know how well State and local government pension plan assets are being managed.

In essence, all that AFSCME asks is a simple right to know, a simple right to know that public employee pension plans are being operated openly and honestly and a simple right to know that public employee pension plans are being well managed and operated without fiduciary abuse.

The millions of State and local government workers and retirees who are counting on these plans for their retirement income deserve no less.

Thank you for the opportunity to express our concerns on this issue which is a major legislative priority of our union.

At the end of the testimony of the panel we will be pleased to answer any questions.

[The statement of Mr. McEntee follows:]

STATEMENT OF THE AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES

Chairman Rangel, Chairman Clay and distinguished members of the Subcommittees on Oversight and Labor-Management Relations, I am Gerald W. McEntee, President of the American Federation of State, County and Municipal Employees (AFSCME). I am accompanied by William B. Welsh, Director of AFSCME's Department of Legislation and by Charles M. Loveless, Legislative Representative. We are here representing the more than one million members of AFSCME who work in state and local governments across the nation.

We are pleased to appear before the Subcommittees today to present our views on whether there is a need to enact minimum federal reporting, disclosure and fiduciary standards for state and local government retirement systems.

AFSCME believes that a major crisis currently faces public pension plans and their participants. State and local government pension plans face problems which threaten not only their own fiscal stability and the rights of plan participants and beneficiaries but also the fiscal integrity of state and local governments as well. The benefits design of many of these plans is illconceived, and many are dangerously underfunded. No comprehensive and uniform set of legal principles exist to adequately regulate state and local government plans. Conflict of interest problems are pervasive, and the absence of meaningful reporting, disclosure and fiduciary standards is the order of the day. A coherent federal regulatory framework which recognizes the unique problems and characteristics of state and local plans has yet to be established.

The scope of the crisis confronting state and local government pension plans is graphically documented in an independent study of the state and local plans which was released yesterday. The study, Dollars and Sense: The Case for State and Local Pension Reform, set forth below as Attachment A, was commissioned by AFSCME and was prepared by Thomas Woodruff, former Executive Director of the President's Commission on Pension Policy. It pointedly indicates that the management of state and local pension funds is frequently characterized by conflict of interest, restrictive state laws, political manipulation and unprofessional portfolio management.

We believe the Federal Government has a responsibility for insuring that minimum reporting, disclosure and fiduciary standards are met by state and local government retirement systems. As noted in the exhaustive Pension Task Force Report on Public Employee Retirement Systems, issued in May 1978 by the House Committee on Education and Labor (Pension Task Force), public employee pension plans with combined assets now conservatively valued at over $260 billion exert substantial influence on the political and economic affairs of the nation. We strongly concur with the central conclusion of the Pension Task Force Report and the report of the President's Commission on Pension Policy that current regulation of state and local plans is inadequate and that federal legislation must be enacted to protect the vital national interests involved. In our view, the adoption of uniform federal standards of fiduciary conduct and of reporting and disclosure such as proposed in the Public Employee Pension Plan Reporting and Accountability Act (PEPPRA) which was reported out of the Education and Labor Committee in the 97th Congress is necessary in order to protect plan participants and the public from the wasting of plan assets and plan mismanagement. We set forth below, in greater detail, our reasons for supporting such legislation and our views concerning some of the major problems facing state and local government pension plans.

I. CURRENT REPORTING AND DISCLOSURE PRACTICES OF STATE AND LOCAL PLANS ARE TOTALLY INADEQUATE

The Pension Task Force Report concluded that one of the most disturbing features of most state and local plans is that important benefit and financial information is not reported and disclosed to plan participants, public officials and taxpayers. In many instances, the Report stated, plan participants are not even informed of their basic benefit rights through a simple plan booklet, not even to mention being apprised of the financial condition of the plan. Specifically, the Pension Task Force Report found that approximately 40 percent of the state and local general employee plans surveyed do not regularly furnish participants with booklets or other material describing plan provisions; plan participants in approximately 18 percent of the plans were unable to obtain plan descriptions even upon request. And where plan descriptions were furnished, the Report noted, their utility as disclosure devices varies widely; most are either too brief or elaborate.

The Pension Task Force Report further found that over 70 percent of all public plans and over 60 percent of the federal and the largest state and local plans do not compute the market value of plan assets and thus were unable to supply this information for the Task Force survey. In addition, the Report disclosed that approximately one-quarter of the state plans and 40 percent of the local plans surveyed do not have actuarial valuations performed on a regular basis; indeed, it was found that 5 percent of the state plans and 25 percent of the local plans have not conducted an actuarial valuation within the past ten years. Certaintly, as was emphasized in the Report, a regular actuarial valuation is essential". . . if a true understanding of a pension plan's emerging pension costs is to be realized." Pension Task Force Report, p. 158.

While the Pension Task Force Report cited numerous other shortcomings in state and local plan reporting and and disclosure practices,[1] suffice it to state that the majority of state and local pension systems do not provide for regular, meaningful reporting and disclosure. The result has been that such systems ". . . are not operated in accordance with the generally accepted financial and accounting procedures applicable to private pension plans and other important financial enterprises." Pension Task Force Report, p. 3. Due to the absence of strong reporting and disclosure requirements, few pension plan participants and beneficiaries have a realistic assessment of their pension entitlements or of the strengths and weaknesses of their retirement systems.

Two recent studies by public pension experts corroborate the Pension Task Force's position that reporting by most public plans, including many of the largest, is inadequate. The national accounting firm of Coopers and Lybrand, in a survey of the financial disclosure practices of 46 major municipal public employee retirement systems, found "(s)erious deficiencies (to) exist in the extent to which key information is reported and reviewed, creating great potential for abuse."[2] Coopers and Lybrand found that: 76 percent of the annual reports studied did not disclose the actuarially computed value of unfunded vested pension liabilities; 63 percent did not disclose the accounting policies related to their plans; 35 percent did not disclose their funding policies; and actuarial assumptions used in a number of the valuations appeared invalid.

A study released in 1981 by the Urban Institute on the annual reports of 86 state and local plans representing more than 20 percent of public plans having 1,000 or more members also expressed serious concern regarding the reporting and disclosure practices of state and local plan administrators and sponsoring governments.[3]

The Urban Institute study noted, for example, that ". . . current financial reporting does not provide sufficient information to judge the financial performance of many of the funds . . . Many plans do not disclose the current market value of plan assets, (n)or do they typically provide information that would permit the evaluation of investment manager performance."[4]

In a study of New England's public pension plans released in September 1982, Alicia H. Munnell and Kristine M. Keefe found serious deficiencies to exist in the way New England's public pension system report and disclose important pension information to plan participants, public officials and taxpayers. Explaining the difficulty of surveying state and local government pension systems in the New England states, Munnell and Keefe state: The task of acquiring reporting and disclosure documents from the various state and local plans often involved contacting several government agencies within each state for information on a single plan. While we initially intended to include locally as well as state-administered plans in this survey, this goal soon proved impossible. Although the various plan administrators of the state systems were receptive to the numerous inquiries and requests, most could not provide any specific information about the locally administered plans within their state. The lack of knowledge regarding the existence and operation of independent plans was most apparent in the State of Connecticut. For instance, while the Pension Task Force Report states that Connecticut has 155 locally administered systems, the state retirement system does not maintain a list of the number or location of those local plans. The division could only provide a print-out of the 479 local political entities reporting for social security purposes with a red asterisk beside those 77 entities that belong to the State Municipal Retirement System. Apparently, the only way to find out if the 402 remaining entities have their own pension plans would be to contact each one directly.[5]

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[1] For exmple, the Report found that nearly one-third of all state and local plans surveyed, including 37 percent of the larger plans, do not provide for an annual system audit of any kind.

[2] Coopers and Lybrand, Financial Disclosure Practices of the American Cities III: Managing Pension Costs (New York: Coopers and Lybrand, 1979), p. 6.

[3] The Urban Institute, The Future of State and Local Pensions (1981).

[4] Ibid., pp. 16–17.

It should be emphasized that the lack of regular, systematic reporting and disclosure practices does not merely pose a problem for plan participants and beneficiaries; taxpayers, investors and even government officials are kept in the dark regarding the true costs and investment practices of the plan. As was noted by Louis M. Kohlmeier in his study of the asset management practices of state and local pension funds: Most public pension plans make financial reports of some kind to the legislature, to the governor or mayor, to employees and/or to the general public. The great majority of such disclosures are wholly inadequate to allow legislators, employees or the public to judge the inadequacy of fund administration. . . . Rarely do reports disclose (investment information capable of being analyzed).[6]

Accordingly, the ". . . potential for abuse is great due to the lack of independent and external reviews of the operations of many plans." Pension Task Force Report, p. 3.

II. EXISTING FIDUCIARY PROTECTIONS FOR PUBLIC PLAN PARTICIPANTS ARE INADEQUATE

Like those of their private sector counterparts prior to the enactment of ERISA, the legal rights and remedies of public plan participants are controlled by state and local law. In calling for the adoption of a uniform federal standard of fiduciary conduct for public plan fiduciaries, the Pension Task Force Report found that state and local control over the management of plan assets frequently has been inadequate as are the existing legal protections for public plan participants. Conflicts of interest in management and investment practices and other clear examples of fiduciary misconduct have occurred due to the absence of a uniform standard of conduct applicable to public plan fiduciaries. While "(t)here is virtual unanimity within the pension community that those who have control of pension plan assets should be held to high standards of behavior and should face liability upon failing to satisfy that standard . . . throughout the universe of state and local government retirement systems there is a virtual absence of clear guidelines in this vital area." Pension Task Force Report, p. 188.

Kohlmeier's study of state and local pension asset management practices, noted above, documents the prevasive nature of conflicts of interest in the management of state and local government retirement system. The study points, in particular, to a recurring tendency on the part of plan fiduciaries to manage and invest plan assets in manner consciously calculated to benefit interests other than those of plan participants and beneficiaries. Kohlmeier stated: One of the most persistent conflict-of-interest situations in the management of public pension funds results from the policy, followed by many plans, of hiring local bankers, brokers and investment advisors and the practice of investing in local securities, even though better or lower cost services and higher yielding investments may well be available outside local boundaries.[7]

And, as noted in both the Pension Task Force and Kohlmeier studies, "(t)his investment and management proclivity becomes undesirable when plan trustees and fiduciaries favor locally oriented service providers and investment despite the fact that such investments may not be in the best interest of the plan and its participants." Pension Task Force Report, p. 191. Indeed, whether mandated by custom or statute, this policy frequently has operated to the substantial detriment of plan participants and beneficiaries.

An additional example of widespread fiduciary abuse documented in both the Pension Task Force and Kohlmeier studies is the absence in many state and local plans of professional investment management. Typically, investment professionals are not on the board of pension fund trustees which under statute is generally responsible for plan asset administration and investment management. Needless to say, the placement of investment and management and asset administration responsibilities in the hands of non-expert officials". . . often produces investment policies and practices that are significantly less valuable than that expected from professional investment advisors and managers, and generally found in private sector plans." Pension Task Force Report, p. 190. To the extent that the plan consequently yields a lesser return on its investments, it is of course the plan participants and beneficiaries that suffer.

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[5] Alicia H. Munnell and Kristine M. Keefe, "PEPPRA: Do New England's Public Pension Systems Need Federal Regulations?" New England Economic Review, September-October 1982, pp. 11-12.

[6] Louis M. Kohlmeier, Conflicts of Interest: State and Local Pension Fund Asset Management (Twentieth Century Fund 1976), pp. 9-10.

[7] Ibid., p. 23. See also Michael T. Leibig and Robert W. Kalman, "How Much Federal Regulation do Public Funds Need," Pension World, August 1978, p. 22, and the Pension Task Force Report, pp. 190-192, which discusses the Kohlmeier study.

Contrary to the view espoused by some opponents of federal reform action, reform of state and local pension plan fiduciary requirements is moving slowly, and the prospects for significant improvement in the foreseeable future are not encouraging. A recent update of Appendix 5 of the Pension Task Force Report, prepared by the Congressional Research Service, which reviews current legal restrictions on the activities of public plan fiduciaries confirms the fact that there has not been a "recent upsurge in reform activity.[8] Attempts at reform are too often thwarted by local business or political interests.

III. CURRENT FEDERAL-STATE REGULATION OF STATE AND LOCAL PLANS IS WHOLLY INADEQUATE TO PROTECT THE INTERESTS OF PUBLIC PLAN PARTICIPANTS

In their article, "How Much Federal Regulation Do Public Plans Need,[9] set forth below as Attachment B, Michael Leibig and Robert Kalman concluded that the current statutory and common law framework applicable to state and local retirement systems has failed to provide an adequate means of protecting the interests of plan participants and beneficiaries. They stated: For the most part, private remedies are technically available. Common law, and often, statutory fiduciary protections do exist. State freedom of information and consumer protection systems are available. These remedies, however, are cumbersome and expensive. They are not designed to provide specific remedies to pension participant or beneficiary problems. Fiduciary duty litigation against the state systems face difficult separation of power and sovereign immunity problems. For the most part, these problems cannot be overcome without sophisticated, expensive legal skills.[10]

Leibig and Kalman's conclusions reinforce the findings of the Pension Task Force that the states have generally failed to establish clear fiduciary standards and effective legal remedies for plans and plan participants in the event of fiduciary misconduct. Even in those instances where state statutory law appears to provide significant protection for plans and plan participants, the law frequently has been judicially interpreted in such a manner as to limit its actual protective effect.

The Federal Government already has certain important responsibilities for regulating state and local pension plans, but it has largely neglected its responsibilities. In another article by Leibig and Kalman, entitled "Federal Policies Toward State and Local Pensions: Benign Neglect or Negligence?",[11] set forth below as Attachment C, various of these responsibilities are catalogued: the Internal Revenue Service's public pension obligations, the Department of Labor's public pension policies and other areas of federal involvement particularly in the areas of preventing fraud and enforcing fiduciary duties. See also Part II of the Pension Task Force Report, entitled "Federal Law Presently Affecting Public Employee Retirement Systems," pp. 7–42.

Certainly the most significant body of federal law presently applicable to state and local plans is the system of tax qualification requirements found under Internal Revenue Code Sections 401(a) and 501(a). However, the enforcement of these requirements generally has been neglected in the public sector; indeed, according to the Pension Task Force Report, "enforcement of the qualification standards against public plans has been for the most part non-existent." Pension Task Force Report, p. 33. In this regard, Robert Tilove noted: Some difficulty arises when rules designed for corporate pension plans are applied to public plans. However, with rare and only very recent exception, the rules have in fact not been applied, except when question has been formally raised. The answer is given, at least in the first instance, by the local director of the Internal Revenue Service. Consequently, answers differ from one state to another, as is to be expected when a complex set of rules written to assure even-handed treatment of corporate executives and the rank-and-file in private industry is applied to public plans. Many public systems have never asked for rulings as to whether their plans qualify; they and their members have simply assumed that there is no problem.

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[8] Congressional Research Service, An Analysis of the Fiduciary Responsibility Requirements of the Major Pension and Retirement Plans for Employees of the 50 States (April 4, 1979).

[9] Michael T. Leibig and Robert W. Kalman, "How Much Federal Regulation Do Public Plans Need," Pension World, August 1978, p. 22.

[10] Ibid., pp. 24–25.

[11] Michael T. Leibig and Robert W. Kalman, "Federal Policies Toward State and Local Pensions: Benign Neglect or Negligence," Employee Benefits Journal, Fall 1978, p. 16.

Nonenforcement by the Internal Revenue Service has in fact been the rule. If enforcement were attemped, it would confront the question whether to assess most state and local judges for thousands of dollars of back taxes because of their superior benefits. Awkwardness has arisen—at least until 1973—only for those system trustees or officials meticulous enough to ask for a ruling.[12]

The Internal Revenue Service's lack of enforcement of the nondiscrimination and other plan qualification requirements can also be graphically illustrated by the Pension Task Force Report's finding that over 80 percent of state and local systems were either unfamiliar with the application of the tax qualification requirements to public plans or, for whatever reason, neglected to apply for qualified status. The Task Force survey further found that only 23 percent of the local plans applied for and received favorable plan determination letters in the past and that the great majority of these determination letters were issued over five years ago, raising the inference that they may not be up to date.

The Pension Task Force Report included a comprehensive examination of federal law presently affecting public sector plans. The Report noted that, in many instances, the precise impact of these laws on public plans is not yet clear and that inconsistent interpretation and enforcement of various federal legal requirements is not uncommon. "The absence of any single federal agency to coordinate the administration and enforcement of the various federal laws relating to retirement income," the Report stated, "has precluded the development of a unified national policy with regard to either public employee retirement systems or private pension plans." Pension Task Force Report, p. 2.

IV. THE PEPPRA BILL NOT ONLY SERVES AS AN EFFECTIVE FEDERAL RESPONSE TO THE PUBLIC PENSION CRISIS BUT MINIMIZES THE DEGREE OF FEDERAL GOVERNMENT INTRUSION IN STATE AND LOCAL GOVERNMENT AFFAIRS

Legislation along the lines of the Public Employee Pension Plan Reporting and Accountability Act (PEPPRA) which was reported out of the Education and Labor Committee in the 97th Congress must be enacted to regulate the operation of state and local government retirement systems. This legislation which we believe recognizes the unique problems and characteristics of public pension plans is necessary in order to effectively deal with the major national problems enumerated above. It should be emphasized that the current PEPPRA bill does not mandate the existence of a state or local pension plan or the level of benefits to be provided. Instead, it merely seeks to provide some assurance that benefits promised under a voluntarily adopted plan are paid and that the plan is operated without discrimination, dishonesty and fiduciary abuse.

In our view, PEPPRA only serves as an effective federal response to the public pension crisis but minimizes the degree of federal government intrusion in state and local government affairs. This measure would establish minimum federal reporting and disclosure and fiduciary standards for state and local government pension plans. The bill contains specific authorization for state governments to have responsibility for administration and enforcement of certain of PEPPRA's provisions. If a state's laws in the areas of reporting and disclosure, bonding, civil and criminal penalties and protection of participant rights are "substantially equivalent" to the requirements of the federal legislation, the state may apply for authority to assume the responsibility in those areas. This will insure that the scope of federal regulation is kept to a minimum and avoid unnecessary duplication of paperwork.

State and local plan compliance with a uniform federal reporting and disclosure standard is urgently needed in order to protect the rights and interests not only of plan participants and beneficiaries, but also of the public at large. While ERISA imposes certain minimal reporting requirements on public plans, the report and disclosure practices of most state and local plans fall woefully short of the standards established for private plans under ERISA. State and local plans must be required to provide a meaningful, yet understandable, explanation of the rights and responsibilities of plan participants and beneficiaries. Plan participants have an interest not only in the disclosure of information regarding the specific provisions of the plans which cover them but also in information as to the strengths and weaknesses of their retirement systems.

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[12] Robert Tilove, Public Employee Pension Funds (New York: Columbia University Press), p. 248F.

A uniform federal standard of fiduciary conduct should be mandated for state and local public employee retirement systems. We concur with the position taken in the PEPPRA bill that "(f)iduciaries should be required to act prudently and for the exclusive purpose of providing benefits to plan participants and that the associated plan assets therefore 'belong' exclusively to them rather than to the sponsoring government." Adoption of an ERISA-type fiduciary standard is necessary in order to protect plan participants from the wasting of plan assets and plan mismanagement. Certainly, no less should be expected from those individuals involved in the management and disposition of public funds than that expected and required of fiduciaries in the private pension community.

In their study of New England's public pension plans, noted above, Munnell and Keefe cogently outline the policy reasons why PEPPRA legislation should be enacted. "Despite the opposition from plan administrators and state and local officials," they conclude, "our survey of the major New England public pension systems indicates that the passage of PEPPRA would benefit public employees covered by state and local pension plans as well as the taxpayers who must pay a large portion of the costs." [13]

We believe that enactment of PEPPRA is necessary in order to protect the vital national interests involved and will overcome any possible constitutional objection raised by the United States Supreme Court's decision in *National League of Cities* v. *Usery,* 426 U.S. 833 (1976). In Usery, the Supreme Court, based on its reading of the consitutional relationship of the states to the Federal Government under the Commerce Clause, declared unconsitutional the application of the mandatory minimum wage and maximum hour provisions of the Fair Labor Standards Act to state and local governments. The Court held that imposing these provisions on such governmental entities would "impermissibly interfere with the integral governmental functions" of the states exercising their Tenth Amendment rights and impair their "ability to function effectively in a federal system". Importantly, as was emphasized in the Pension Task Force Report's discussion of the case, federal reporting, disclosure and fiduciary standards legislation ". . . would produce a very slight cost impact in terms of compliance by state and local governments" and in fact may result in ". . . a net reduction in cost . . ." and thus would not reach the level of intrusion in integral state government functions which the Court found objectionable in Usery.[14]

V. CONCLUSION

AFSCME believes that the enactment of minimum federal reporting, disclosure and fiduciary standards will not only serve to protect the rights of public participants and beneficiaries but also will protect a compelling public interest as well. We thank the Members of the Subcommittees for the opportunity to present this statement, and we look forward to continuing to work with you on this matter of utmost concern to state and local government employees. We will be pleased to answer any questions you may have.

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[13] Munnell and Keefe, op cit., p. 24.

[14] See the Pension Task Force's discussion of Usery, Pension Task Force Report, pp. 17-22.

DOLLARS AND SENSE:

The Case for State and Local Pension Reform

By Thomas C. Woodruff

ATTACHMENT A

Preface

This independent report on state and local government retirement systems by Thomas Woodruff, former Executive Director of the President's Commission on Pension Policy, highlights a serious and troublesome national problem. This report, the report of the Pension Task Force of the House Education and Labor Committee and numerous other public and private studies all underscore one essential fact: our state and local public employee retirement systems are on the brink of a major crisis. The problems threaten more than the fiscal stability of these plans; they threaten as well the many people who depend on public retirement systems for their current or future economic security; and finally, they threaten the basic fiscal integrity of state and local governments.

From our studies of these many reports, we believe that certain conclusions are inescapable:

- Many public pension systems are dangerously underfunded.
- There is no comprehensive and uniform set of legal principles that adequately safeguards the operation of state and local plans.
- Fiduciary protections are far less than they should be; meaningful standards for reporting and disclosure are notable by their absence.
- Until this time, the Federal Government has done little to protect the millions of participants who are affected.

Unlike their counterparts in the private sector who are protected by ERISA, state and local government workers have virtually no federal retirement income protections. It does not seem an unusual notion that the assets of any pension plan "belong" to its participants, that the assets should be invested for the "exclusive benefit" of the plan's participants and beneficiaries, and that individuals who control those assets should be held under law to a high standard of behavior. In fact, all this is the case in the private sector. Unfortunately, it is by no means a settled proposition in the public sector. Conflicting and ambiguous state and local laws and court decisions have created much uncertainty about the legal rights of participants in public pension plans.

As a constructive means of addressing the public pension crisis, the American Federation of State, County and Municipal Employees (AFSCME) strongly supports the enactment of minimum federal reporting and disclosure and fiduciary standards for state and local government retirement systems. By focusing on these areas, such legislation will minimize the degree of federal intrusion in state and local government affairs. Effective reporting and disclosure and fiduciary standards will ensure that state and local pension problems are solved at home, rather than in Washington, D.C.

At a time when a debate is getting underway on the formation of a national industrial policy and the use of pension assets as an integral component of that policy, the enactment of strong reporting and disclosure and fiduciary standards for state and local plans becomes even more important.

Gerald McEntee
President
American Federation of State, County
and Municipal Employees.

Introduction

Currently, Congress is considering the Public Employee Pension Plan Reporting and Accountability Act (PEPPRA), legislation that would establish reporting, disclosure, and fiduciary standards and administrative and enforcement procedures for this nation's 6,600 state and local pension plans.

Over 13 million retired and active state and local government employees depend on these plans to provide them with income security upon retirement. The absence of uniform standards governing these plans has left the retirement income security of millions of state and local employees in doubt. Moreover, state and local government taxpayers will ultimately pay the price for fund mismanagement.

State and local government employees forgo billions of dollars in wages and other forms of compensation each year in order to participate in these pension plans. But, they do not enjoy the same rights and protections as their counterparts in the private sector.

Currently, the pension funds for state and local employees hold over $260 billion in assets. They are predicted to grow at a rate of nearly $30 billion per year for the next five years. These pension funds are an important source of capital for the states in which they reside and the nation as a whole. Yet the management of these funds is often characterized by conflict of interest, restrictive state laws, political manipulation, and unprofessional portfolio management. Attempts at reform are too often thwarted by local business or political interests.

PEPPRA does not propose to regulate all aspects of state and local pension plans. Instead. PEPPRA seeks to reform practices of these plans with a minimum of federal intervention. The Act would provide for:

- federal reporting and disclosure standards;
- federal fiduciary standards;
- administrative and Enforcement Procedures; and
- creation of an Advisory Council on Governmental Plans.

Experience with private pension plan regulation has shown that adequate and uniform reporting and disclosure standards are the least intrusive and most effective way to reform pension abuse. Federal standards are necessary to ensure comparability of data from plan to plan and state to state.

PEPPRA seeks to apply the same fiduciary standards found in the Employee Retirement Income Security Act (ERISA) to state and local pension fund management. These standards have proved to be effective in significantly reducing abuse in the management of private pension plan assets. Government sponsors and plan participants would benefit from nearly a decade of case law and enforcement experience if these standards were applied to state and local plans as well.

PEPPRA is silent on many standards important to state and local pension reform: participation, vesting, funding, limits on benefits or contributions, and survivor benefits. In addition, no mention is made of two potentially troublesome public policy issues: plan termination insurance, and social security coverage.

The legislation does provide for the establishment of an Advisory Council on Governmental Plans. In its proposed form, this Council promises to be yet another toothless governmental advisory group. If, however, Congress gave this group independence from the Administration, as well as an adequate staff and budget, the Advisory Council could become a catalyst for continued state and local reform. If the Council were successful in its efforts, further federal action might be unnecessary.

In its current draft, certain compromises were made to reduce state and local government opposition to PEPPRA's passage. One unfortunate compromise allows governors to exempt plans in their states from the reporting and disclosure requirements if state or local laws or regulations are "substantially equivalent" to PEPPRA's. When it comes to disclosing key investment, accounting, and actuarial information, the data must be calculated on the same basis in order to be of any value. Disputes over the meaning of the term "substantially equivalent" could very well render the reporting and disclosure provisions of PEPPRA "substantially useless."

In spite of its deficiencies, PEPPRA represents an important step toward reform of the nation's state and local pension plans. A few key amendments would greatly increase its effectiveness. Involvement of important state and local organizations in the activities of a strengthened Advisory Council on Governmental Plans would ensure that the reform process begun by PEPPRA will continue without further federal intervention. Enactment of the reporting and disclosure standards outlined in the legislation would provide solid guarantees both for plan beneficiaries and for the average taxpayer.

In summary, the following points and conclusions can be made:

- the management of the nation's 6,600 state and local government public employee pension funds often produces conflicts of interests, unprofessional portfolio management and political manipulation.
- there is an absence of uniform reporting and disclosure standards which make evaluations of state and local plans difficult, if not impossible.
- legislation now being considered by the Congress would be an important step in assuring that the policymakers, the taxpayer and the plan beneficiaries in state and local government are fully appraised of financial conditions and the management of public employee plans which hold $260 billion in assets.

Public Employee Retirement Plans

Public employee retirement plans are extremely diverse. The single most comprehensive study of state and local pension plans remains the report of the House Pension Task Force in 1978. Since that time, a number of other detailed studies have been conducted by several executive branch agencies, the President's Commission on Pension Policy, and a number of state and local organizations. In general, these additional studies have tended to confirm the findings of the House Pension Task Force.

In all, there are 51 federal plans and approximately 6,630 state and local pension plans.[1] Since federal law (PL95-595) governs reporting and disclosure for federal plans, only the state and local plans would come under regulation if PEPPRA were enacted. Approximately 13 million current employees and retirees are covered by these plans.[2]

Most of the 6,630 plans are relatively small: according to the House Pension Task Force report, approximately 75% of the plans cover fewer than 100 workers, while only 2% cover over 10,000 workers.[3] However, most employees are covered by large plans: nearly 70% of the employees are covered by the largest 100 plans.[4]

Administration of these plans is also fragmented. According to the Task Force report, 9.6% of the plans are administered by states, 59.5% by cities, 4.6% by counties, 22.6% by townships, and 3.8% by special governmental districts (such as transit authorities).[5]

The following table shows the percentage distribution of covered employees by employment category.

TABLE 1

DISTRIBUTION OF RETIREMENT SYSTEM ACTIVE EMPLOYEES BY EMPLOYMENT CATEGORY

Category	Percentage of Employees
Federal	.1
State	22.8
Local	26.7
Police and Fire	6.7
Teachers	30.0
Teachers (higher education)	3.9
Other	9.7
Total	100.0

(Source: Table B6, Task Force Report, p. 58)

This table shows that teachers make up the largest single block of public employees covered by pension plans. While police and fire pension plans make up over 66% of all state and local pension plans,[6] they only represent 6.7% of all employees. Most police and fire pension plans are relatively small.

Administration of these pension plans is somewhat fragmented, even though over 40% of the plans have realized some economies through administration by multiple governmental bodies.[7]

Both the House Pension Task Force in 1978 and the President's Commission on Pension Policy in 1981 concluded that most governmental bodies have failed to develop comprehensive pension policies. This failure has led to a hodgepodge of programs that provide overly generous benefits to some and inadequate benefits to others. Inadequate funding policies have led some municipalities and states to either reduce pension benefits or seek new tax revenues for pensions already promised.

Since 1978, a number of states, as well as a number of state and local organizations, have created special commissions, task forces, and study groups to propose state and local pension reform. Some states have formed permanent retirement commissions to monitor the operations of pension systems. About 70% of the plans are administered by either an investment board or a retirement board. In general, these boards exercise full authority in investing plan assets.

Foremost among the national groups proposing pension reform have been the Municipal Finance Officers Association (MFOA), the National Governor's Association (NGA), and the National Conference of State Legislators (NCSL). While these groups have generally agreed with the need for reform, they have suggested that federal regulation is not the solution. Instead, they have conducted studies leading to "guidelines" for state and local governments to follow on a voluntary basis.

Some states have attempted to move from the "guideline" stage to implementation, with mixed results. In a few states, like California, heated political battles over reform legislation have produced mixed results. In that state, improvements in fiduciary standards have been signed into law. However, recently, the state's governor vetoed an important piece of legislation designed to take the portfolio management of the state's pension assets out of the political arena and to require full reporting and disclosure. The case of California demonstrates the difficulty of state and local pension reform at the local level.

Most state and local pension plans provide salary and service-related benefits of the defined benefit type. While most of these plans meet ERISA's age, vesting and service requirements, police and fire pension plans tend to have more restrictive vesting schedules.

Approximately 70% of state and local employees covered by pension plans are also covered by social security, as the following table shows. Police and fire employees and teachers are much less likely to be covered by social security than other employees.

TABLE 2
PERCENTAGE OF EMPLOYEES COVERED BY SOCIAL SECURITY

Category	Percentage
State	84.9
Local	75.9
Police and Fire	36.4
Teachers	56.5
Teachers (high education)	83.8
Other	86.6
Average	70.1

(Source: Task Force Report, Table B7, p. 59)

Pension Funds As Economic Institutions

In addition to providing benefits to employees, state and local pension plans are an important source of capital for the economy. Prudent management of these funds is important to both the beneficiaries of the pension trusts and the taxpayers supporting the plans. Table 3 shows how these plans' assets are predicted to grow in the future.

TABLE 3
PENSION PLAN ASSETS (ANNUAL INCREASE)
(Market value at year end in $ Billions)

Type	1983	1984	1985	1986	1987
Defined Benefit	761	838	951	1,036	1,185
Corp.	424	471	538	589	678
State & Local	260	283	318	344	387
Multi-Employer	65	71	79	86	98
Non Profit	13	14	16	18	21
Defined Contribution	228	265	314	348	406
Corporate	184	215	255	283	331
Nonprofit	44	50	59	665	75
DB & DC Total	989	1,103	1,265	1,384	1,591

Source: ICP, Inc.

Currently, state and local pension plan assets exceed $260 billion and are predicted to grow by approximately $30 billion annually over the next five years. The size of these pension funds ranges from very small plans with under $100,000 in assets to the largest system, California, covering thousands of employees with over $28 billion in assets.

While the growth of these funds may be a measure of increased retirement income security for participants and beneficiaries, it also suggests a danger: the very size of these funds makes them easy targets for diversion to purposes other than providing a proper rate of return to finance benefits.

Inadequacy of State And Local Regulation

Between 1979 and 1981, the President's Commission on Pension Policy reviewed the findings of the House Pension Task Force Report, initiated and coordinated new research on state and local pension plans, and held hearings around the country on problems with these plans. The final report of the President's Commission agreed with the House Pension Task Force that problems exist in the following areas: participation, vesting, reporting, disclosure, funding standards, fiduciary responsibility, limits on benefits or contributions, survivor benefits, and plan termination insurance.

Ironically, inadequate reporting and disclosure have hampered the development of conclusive research in some of these areas. However, enough is now known about some problem areas to suggest the need for immediate reform.

Inadequate Fiduciary Standards

Prior to the establishment of ERISA, private sector employees had to rely on state and local laws to protect them from abuse by plan administrators and trustees. Pension experts universally agree that the establishment of uniform fiduciary standards by ERISA has had a major influence on ending pension fund mismanagement. Both the President's Commission and the Pension Task Force concluded that public employees need this same protection.

The absence of uniform fiduciary standards has led to abuses such as conflicts of interest in management, and unprofessional investment practices. In the words of the Pension Task Force report: "There is virtual unanimity within the pension community that those who have control of pension assets should be held to high standards of behavior and should face liability upon failing to satisfy that standard . . . throughout the universe of state and local government retirement systems there is a virtual absence of clear guidelines in this vital area."[8]

A study conducted by Louis Kohlmeier for the Twentieth Century Fund documents widespread conflicts of interest in the management of state and local pension funds: "One of the most persistant conflict-of-interest situations in the management of public pension funds results from the policy, followed by many plans, of hiring local bankers, brokers and investment advisors and the practice of investing in local securities, even though better or lower cost services and higher yielding investments may well be available outside local boundaries."[9]

Some of this activity is well-intentioned: legislators and plan administrators sometimes seek to encourage local business. Often, state law will specify that certain types of investments, such as mortgages or municipal bonds, must make up a fixed portion of the pension portfolio. In addition, some state laws exclude investments in certain financial instruments such as corporate stocks.

Whether or not well-intentioned any sacrifice in investment return due to these restrictions may not be in the interest of either the beneficiaries of the pension plans or the taxpayers that support them.

Another area of fiduciary abuse highlighted by both the Pension Task Force Report and the Kohlmeier study concerns the absence in many states of professional investment management. Frequently, pension fund trustees are nonexpert in the field of portfolio management. This "often produces investment policies and practices that are significantly less valuable than that expected from professional investment advisors and managers, and generally found in private sector plans."[10]

In spite of the number of reports calling for changes in state and local fiduciary practices, local reform has been extremely slow, and the prospects for significant changes in the near future seem remote.

Even the experiences in states that have made moderate progress in pension reform illustrate the dangers of relying on that process for significant change. The battle for reform of California's fiduciary, investment management, and reporting and disclosure practices provides a current example.

For the past several years, the state legislature has been debating reform of the management practices of California's two large public employee pension funds, totaling over $28 billion in assets. A Joint Committee on Public Pension Fund Investments has, for the past two years, hired consultants, held hearings, conducted studies, sought the advice of experts throughout the country, and drafted legislation.

Consultant reports to the Committee found that the funds were difficult to oversee due to inadequate reporting and disclosure, that fund administration was not insulated from the political process, that portfolio performance suffered from the quality and quantity of resources devoted to investment staff, and that guidelines for trustee behavior did not exist.[11] The major consultant to the Committee, Dr. Marcy Avrin, reported that the taxpayers of California could save hundreds of millions of dollars per year by increasing the return of the pension portfolio to reasonable levels.[12]

The bills that were presented to the state legislature by the Joint Committee in 1982 and 1983 have been nearly universally praised by pension and investment experts.[13] At first it seemed successful passage of these bills was ensured. In 1982 an important breakthrough was made with the enactment of an ERISA-like prudence standard. However, when the legislature attempted to add teeth to this provision, with passage of a bill adding a comprehensive reporting and disclosure provision and separating the investment board from executive branch and legislative influence, the governor vetoed the bill.[14] Even if the legislature eventually prevails, this veto illustrates the difficulty of significant pension reform on the state and local level. It is unlikely that most states and municipalities will devote the time and resources for reform that California has.

By their very size relative to the budgets of their governmental sponsors, public pension funds are easy targets for budgetary and political manipulation.[15] Politicians are unlikely to relinquish their control over these funds voluntarily. Furthermore, full disclosure may lead to embarrassing reports of underperformance by political appointees. As long as the disclosure of this performance can be hidden or delayed, those responsible will not be held accountable.

Inadequate Reporting And Disclosure

Virtually every major study of state and local reporting practices has found serious inadequacies. Frequently, important financial, actuarial, and accounting calculations are either not performed or not revealed. In many instances, plan participants are not even informed of their basic plan benefits and legal rights through simple summary plan descriptions.

Most experts agree that complete reporting and disclosure of financial and benefit information is the least intrusive way to reduce abuse by pension trustees and plan administrators. Due to the highly complex nature of pensions, inadequate disclosure makes it impossible for even experts to detect abuse or mismanagement until it is too late: when pension promises are broken or additional taxes must be raised to prevent insolvency.

This point was emphasized by Louis Kohlmeier in his study of asset management practices: "Most public pension plans make financial reports of some kind to the legislature, to the governor or mayor, to employees and/or the general public. The great majority of such disclosures are wholly inadequate to allow legislators, employees or the public to judge the inadequacy of fund administration. . . . Rarely do reports disclose [investment information capable of being analyzed].[16]

In 1978, the House Pension Task Force concurred when it concluded that the "potential for abuse is great due to the lack of independent and external reviews of the operations of many plans."[17]

Late in 1978, the newly established President's Commission on Pension Policy began to coordinate an interagency research effort on state and local pension plans that resulted in three major reports in 1980 and 1981. Each of these reports confirmed this conclusion by the House Pension Task Force.

The first report, conducted by the Urban Institute, examined a sample of 100 large pension plans. "While these plans are generally considered to have the best reporting and disclosure of all state and local plans, Table 4 shows that even they have serious gaps in disclosure.

TABLE 4

Frequency of Disclosure of Particular Items in Annual Reports

Item	Percentage of Plans Including
Auditor's opinion	40
Report of assets, liabilities, etc.	99
Statement of changes in reserves	54
Statement of factors (e.g., litigation and trends) that may affect financing and operation	33
Statement of investment policies and restrictions	47
Portfolio by asset type	93
Funding policy for employers and members	58
Date of last actuarial report	65
Changes in actuarial assumptions	23
Summary of actuarial assumptions	37
Amount of liability (actuarial balance sheet)	71
Number of former employees vested but not yet getting benefits	43
Number of beneficiaries	86

Source: Technical Appendix, *Coming of Age: Toward A National Retirement Income Policy*, President's Commission on Pension Policy, 1981 p. 608.

Annual reports should contain complete accounting, actuarial, and financial information. However, the federally sponsored Urban Institute study showed a number of deficiences. Only 40% contained an auditor's opinion, and only 33% contained a statement of factors that might affect financing and operation. While 99% contained a statement of assets and liabilities and 71% contained an actuarial balance sheet, only 37% disclosed actuarial assumptions used to perform the calculations, and only 23% disclosed changes in actuarial assumptions that might affect year-to-year variations in the reported numbers. Without these further disclosures, the other figures are virtually meaningless even to experts.

Disclosure of adequate investment criteria and performance was also found lacking: only 47% disclosed even a statement of investment policies and restrictions.

The second product of the federal pension research effort was a report issued in 1981 by SRI International on small- and medium-sized state and local pension plans. Table 5 shows a summary of SRI's reporting and disclosure findings.

TABLE 5

Availability of Information on Plans

Type of Document	Document Exists (%)	Document Available to Employees (%)	Document Available to the Public (%)
Descriptive booklet for participants	58.0	49.3	40.7
Law, ordinances or code	71.3	66.7	63.3
Recent annual report	92.0	84.7	77.3
Recent actuarial report	88.0	77.3	70.0
IRS 5500G form	92.7	83.3	76.0

Source: Technical Appendix, *Coming of Age: Toward a National Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 609.

According to the report, fewer than half the employees have a booklet describing the benefits and eligibility criteria for their plans. Other documents such as annual reports, actuarial reports, and ordinances governing the plans are too often available to neither the employees *nor the public.*

The third report of the federal research effort was a report on financial reporting and disclosure prepared by the Municipal Finance Officers Association. They concluded that "available information indicates such reporting is today inadequate and confused and clearly in need of repair. Several factors contribute to the lack of good disclosure about [state and local] pension systems. . . ."[18] Further, the MFOA concluded that these deficiencies were due to a "lack of general authoritative standards for system disclosure and of enforcement of such standards that do exist."[19]

Inadequate Funding Standards

The reporting and disclosure evidence that is available indicates that a potentially serious problem exists with regard to inadequate funding of state and local pension plans. Whether the failure to disclose funding policies means that none exist or that the plans may fall into insolvency is difficult to discern.

Part of the federal research effort referred to earlier involved an attempt to estimate the funding status of state and local pension plans. The findings of this effort show a mixed picture:

(1) Large plans, in the aggregate, appear reasonably well funded;

(2) Some large plans face funding problems;

(3) Small plans cannot be easily evaluated due to inadequate reporting and disclosure;

(4) Small plans appear very vulnerable since many are dependent on outside sources of funds for their annual contributions.

The research project attempted to evaluate large pension funds by simulating their plans' experiences using actuarial cost models developed by Howard Winklevoss Associates. The models showed that the large funds studied seemed to be funding according to reasonable schedules if they were viewed as a whole. However, when viewed separately, some plans, particularly police and fire plans, appeared to face potential problems in the future.

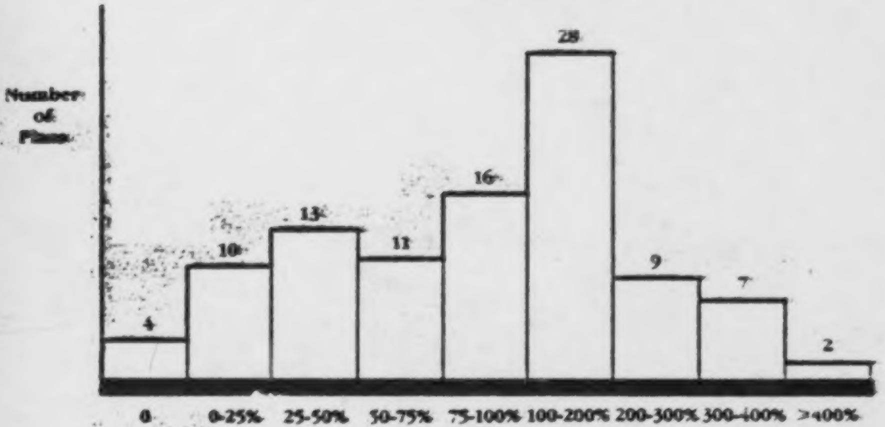
Table 6 shows one way of assessing the funding status of these large pension plans. The current and estimated funding status is measured by dividing the unfunded liability of each plan by the total payroll cost for the current year (1980) and the final forecast year (2024). The table shows that under current funding strategies, only 52% of the plans would be fully funded by 2024 even if no improvements are made in benefit formulas and no ad hoc benefit increases are made for the entire period

TABLE 6

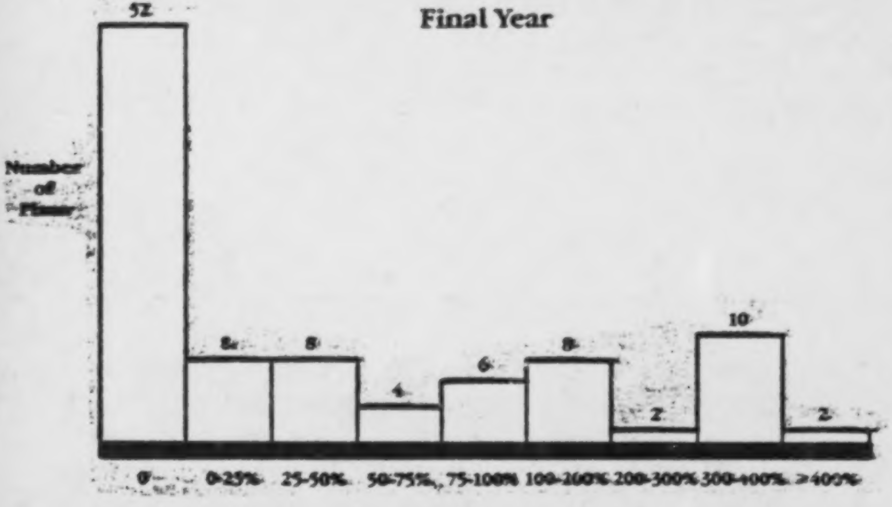
DISTRIBUTION OF UNFUNDED LIABILITY AS PERCENTAGE OF PAYROLL FOR PLANS IN THE 100 PLAN SAMPLE

(Assets accumulated under current funding methodology forecast)

Initial Year



Final Year



Source: Technical Appendix, *Coming of Age: Toward a National Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 605.

Table 7 shows a potential problem for small state and local pension plans: their dependence on other sources for their annual pension contribution. According to this table very small municipal plans are particularly vulnerable. In an era when state and federal aid is being severely curtailed, this table provides reason for concern.

TABLE 7

PERCENTAGE OF TOTAL CONTRIBUTION BY SOURCE

	Number of Participants						
	1-4	5-24	25-99	100-199	200-499	500-999	TOTAL
Mandatory employee contributions	19.9%	18.5%	19.6%	19.6%	24.3%	27.8%	21.0%
Voluntary employee contribution	0.0	0.0	1.6	0.0	0.0	0.0	0.5
Employer contributions	27.1	47.7	58.1	76.5	62.8	72.2	60.3
Other contributions	53.0	33.8	20.7	3.9	12.9	0.0	18.2
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Technical Appendix, *Coming of Age Toward a National Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 606.

While the federal research projects do not provide conclusive proof of a national underfunding problem for state and local pension plans, they do offer evidence of pension plan vulnerability to changes in benefit policies, interest earnings, contribution sources, state and federal budgets, and many other factors that are likely to affect them. Better reporting and disclosure would permit future research efforts to determine whether the funding problems faced by some pension plans are sufficiently widespread to warrant federal standards.

Does PEPPRA Go Far Enough?

Congressional interest in legislation regulating state and local government pension plans dates back to the debates preceding enactment of the Employee Retirement Income Security Act (ERISA). Initially, public pension plans were included in the ERISA bills under consideration. The final legislation that was passed in 1974, however, called only for a congressional study of these plans and the need for federal legislation. The House Pension Task Force report that was issued in 1978 was the product of that congressional effort.

Since the issuance of that report, some form of federal legislation governing state and local pension plans has almost continuously been before the congress. In the 97th Congress, H.R. 4928 and H.R. 4929, the Public Employee Retirement Income Security Act (PERISA), were introduced by Representatives Phillip Burton, Chairman of the House Labor-Management Subcommittee, and John Erlenborn, ranking minority member of the Education and Labor Committee. Identical measures (S.2105 and S.2106) were introduced in the Senate in February by Senator John Chafee, Chairman of the Finance Subcommittee on Savings, Pensions and Investment Policy. The President's Commission on Pension Policy supported the legislation, though it believed that federal regulation of funding and benefit standards should also be included in any such bill.[20]

After state and local government officials raised certain objections at hearings on the bills in February, 1983, the legislation was rewritten with several "deregulatory" provisions. The new legislation, called "The Public Employee Pension Plan Reporting and Accountability Act (PEPPRA), was reported out of the House Education and Labor Committee with only one dissenting vote.

As rewritten, PEPPRA would require reporting and disclosure of certain benefit, financial and actuarial information, as well as establish fiduciary standards and enforcement procedures. States are granted an exemption from certain provisions if the state's governor certifies that state laws have "substantially equivalent" provisions.

Reporting and Disclosure

Professor Roy Schotland of the Georgetown Law School provided a good summary of the importance of federal reporting and disclosure standards when he testified on S.2105 and 2106 on March 29, 1982:

"1. **Effective disclosure activates local political processes, so that pension problems are more likely to be worked out at home.**

2. Disclosure cannot be effective unless local taxpayers and pension participants can **compare** how their funds are doing relative to other similar funds.

3. **Only the federal government can assure comparability** of information about pension plans.

4. **Required disclosure is the least intrusive and least costly form of regulation.** This makes it especially appropriate when, as here, the federal government must take some steps affecting state and local governments in order to protect the federal taxpayers' vulnerability as pension insurer of last resort."[21]

PEPPRA attempts to provide requirements for disclosure of plan information to participants and reporting of accounting, actuarial and investment data to participants, the government, and the public. Unfortunately, the "deregulatory" amendments may have seriously weakened these provisions. In addition, the requirements for investment performance may need elaboration.

Reporting to Participants

PEPPRA requires that a Summary Plan Description (SPD) be provided to participants and beneficiaries. Pension plans are usually a complex form of employee benefit and may have numerous rules and criteria for benefit eligibility. The PEPPRA bills specify twelve items that must be included in the reports to apprise beneficiaries of their rights and obligations under the plans. The bills specify that the SPD must be written in language understandable to the beneficiary population, a formidable task. These requirements seem reasonable and in keeping with private sector practice.

In addition, plan administrators are required, upon request, to provide participants information regarding total accumulated plan benefits, accumulated employee contributions (with interest), and vesting status. This information would be automatically provided all employees who terminate employment with vested benefits.

The Annual Report

The Annual Report is the only document that must include among other things, complete accounting, actuarial, financial and investment information.

The actuarial reporting requirements in PEPPRA reflect Department of Labor (DOL) regulatory changes made in 1978 in ERISA's actuarial reporting requirements as well as requirements suggested by the Financial Accounting Standards Board (FASB) for all plans. In 1978, both the DOL and FASB proposed that plans disclose present value calculations for accrued plan benefits (based on service to date and current salary) using a single actuarial cost method with full disclosure of major explicit actuarial assumptions. In addition both DOL and FASB proposed that these values should be calculated with salary projections.

The DOL eventually dropped its proposal to require salary projections due to claims made by a number of actuaries about the burden of doing so. While FASB concurred at the time, it has since proposed that this projection be included in a plan's financial statements. Plan experience since 1979, when the DOL regulations first took effect, has shown that the calculations of these figures are not "burdensome."

The PEPPRA requirement for the so-called "credited projected benefits" accomplishes what both the DOL and FASB sought in their original proposals in 1978. These salary projections are particularly appropriate for state and local plans since most plans calculate benefits based on either career average or final average salary.

In addition, PEPPRA section 107(d)(1) requires that "the enrolled actuary shall utilize on an explicit basis such assumptions and methods as are necessary. . ." Also, paragraph (d)(2) states that "the actuarial statement shall include actuarial assumptions and methods, plan provisions, and other pertinent factors on the actuarial position of the plan."

Once again, PEPPRA has incorporated DOL regulatory reform and FASB guidelines into the language of the bill. Actuaries have argued that they should be free to use either "explicit" or "implicit" actuarial assumptions. What is an "explicit" assumption? Disclosing "explicit" assumptions merely means that all assumptions are individually related to the expected experience of the pension fund. For example, the use of a 7.5% interest rate assumption means that the actuary is predicting that the rate of return of plan assets for the forecast period will be 7.5%. What then is an "implicit" assumption? An actuary may take the same 7.5% expected investment yield figure and make unspecified "adjustments" due to other factors not taken into account by the other assumptions used (such as employee turnover). The use of implicit assumptions defeats the purposes of actuarial disclosure: comparability of data from year to year and between plans and the ability of experts (other than those who perform the report's calculations) to evaluate the performance of the plan.

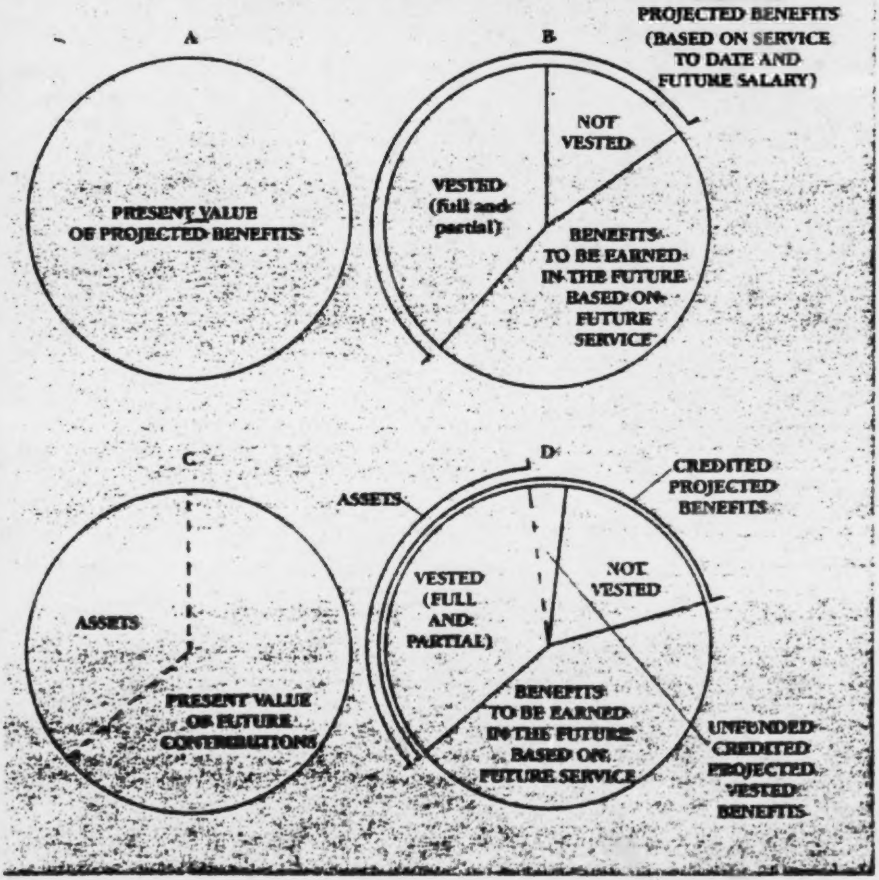
As written, PEPPRA appears to require only disclosure of explicit assumptions for the "actuarial present value of credited projected benefits" figures. This requirement should extend to all actuarial calculations.

While PEPPRA's accounting and actuarial reporting requirements seem reasonably complete, the bill as written lacks any definitive requirement for reporting investment performance. As with ERISA, PEPPRA's disclosure requirements in this area appear to be designed more for enforcement of the prohibited transactions fiduciary standards than for evaluation of investment performance.

Earlier, California's experience with pension reform was briefly reviewed. This past summer, the legislature passed AB 672, which, among other things, called for full disclosure of in-

FIGURE 1

GRAPHIC PRESENTATION OF ACTUARIAL DISCLOSURE UNDER PEPPRA


A
B
CREDITED PROJECTED BENEFITS (BASED ON SERVICE TO DATE AND FUTURE SALARY)
PRESENT VALUE OF PROJECTED BENEFITS
NOT VESTED
VESTED (full and partial)
BENEFITS TO BE EARNED IN THE FUTURE BASED ON FUTURE SERVICE
C
D
ASSETS
CREDITED PROJECTED BENEFITS
ASSETS
PRESENT VALUE OF FUTURE CONTRIBUTIONS
VESTED (FULL AND PARTIAL)
NOT VESTED
BENEFITS TO BE EARNED IN THE FUTURE BASED ON FUTURE SERVICE
UNFUNDED CREDITED PROJECTED VESTED BENEFITS

vestment performance. The bill was vetoed by the governor. Supporters believe that one reason for the veto was that the investment performance disclosure would have exposed serious shortcomings in the management of that state's two pension fund portfolios. Financial experts praised the standards as both complete and reasonable for evaluating a fund's investment performance. Such a requirement is clearly needed as an amendment to PEPPRA. For that reason, the relevant portions of AB 672 are included as an appendix to this report for consideration by Congress and those reviewing PEPPRA.

PEPPRA would permit an assessment of whether current plan assets are sufficient to pay anticipated benefit obligations. In Figure 1, the "unfunded credited projected vested benefits" calculation shows the degree to which plan assets are insufficient to pay benefits already earned by employees, assuming that the current plan continues until they retire.

"Substantially Equivalent" Provisions

As a compromise, the writers of PEPPRA have provided in section 102 that a state's pension plans can be exempted from the specific reporting and disclosure requirements if the governor of that state determines that its own laws are "substantially equivalent." What this term means in the context of numerical information is not at all clear. Even minor deviations in factors such as time periods, method of calculation, inclusion and disclosure of various assumptions, etc., would render this title of the act "substantially useless."

Language could be added to this provision to restrict its application to only the more qualitative requirements of the reporting and disclosure title. The comparability of the key financial, investment, and actuarial data must be preserved if PEPPRA's reporting and disclosure provisions are to have any meaning.

Fiduciary Standards

PEPPRA applies the same basic fiduciary rules found in ERISA to state and local pension plans. Fiduciaries must act solely in the interest of beneficiaries and participants and must use funds for the exclusive purpose of providing benefits and managing the funds. The bills also provide for identical prudence and prohibited transactions rules.

One fiduciary provision is more restrictive than ERISA's. While ERISA limits the acquisition of employer securities to 10% of total assets, PEPPRA would limit this to 5%. As Roy Schotland pointed out in testimony in 1982, state and local pension holdings of such securities have not approached 5% in the past twenty years. Disregarding New York City funds from these calculations reduces this figure to under 2.5% for the past decade. Schotland went on to propose that the ceiling be "2.5%, with provision making clear that existing holdings are "grandfathered" and with legislative history making clear that special situations, like New York's ... shall be treated as that situation was, by special exception with safeguards to protect the federal interest in tax-favored pension funds."[22]

By adopting ERISA's fiduciary standards, all state and local pension plans would come under the same rules that private plans have enjoyed since its enactment. Taxpayers and plan participants alike would realize savings of time and money since the courts and enforcement agencies could refer to nearly a decade of case law and regulations for guidance.

Advisory Council on Governmental Plans

While PEPPRA has made major strides in reform of reporting and disclosure and fiduciary standards for state and local plans, it is silent in regard to funding, vesting, participation, survivor benefits, social security coverage and plan termination insurance. PEPPRA provides that an Advisory Council on Governmental Plans be created to monitor the implementation of PEPPRA and to suggest any amendments that might be needed to the President and to Congress. Furthermore, section 307(c) states: "The Council may establish voluntary guidelines for plans with respect to matters for which requirements are not established by this Act."

The authors of PEPPRA have patterned this advisory council after the ERISA Advisory Council. Like the ERISA Council, the Governmental Plan Council would be totally dependent on the Secretary of Labor for staff support and research. Experience with the ERISA Advisory Council has shown that this arrangement does not work. Since its inception, the ERISA Advisory Council has been given little staff support and has been largely ignored by the Secretary and the ERISA Administrator. In addition, this Administration has shown no interest in funding even the most basic pension research.

The concept of an Advisory Council on Governmental Plans is a good one. An independent body should review the implementation of this law. Furthermore, the input from state governmental officials, labor representatives, and pension experts could help smooth the regulatory process.

The Advisory Council on Governmental Plans could work with the Municipal Finance Officers Association, the National Governors Association, the National Conference on State Legislatures, and others, to encourage the implementation of voluntary guidelines for funding standards, benefit rules, etc., left uncovered by PEPPRA. This group could advise Congress when, if ever, further action may be necessary. To be truly independent, this Council should have its own executive director, staff, and budget, as well as a chairman with a term of office long enough to provide continuity.

Appendix

California Assembly Bill 672: Relevant Excerpts

22218.6. The board shall submit an annual report to the Legislature, which report shall include:

(a) An outside audit of the system, including a cash flow analysis and a review of budget and staffing levels.

(b) A review by a consulting actuary, a summary of any changes in actuarial assumptions from the previous year, a review of the system's asset mix strategy, a market review of the economic and financial environment in which investments were made, and a summary of the system's general investment strategy.

(c) A description of the investments of the system, including the concentration of stocks and bonds, at cost and market value, including dividends and coupons, and a summary of major changes that occurred since the previous year.

(d) The following information regarding the rate of return of the system by asset type:

(1) Time-weighted return on a five-year, three-year, two-year, one-year, and six-month annualized basis.

(2) Dollar-weighted return on a five-year, three-year, two-year, one-year, and six-month annualized basis.

(3) Portfolio return comparisons which compare investment returns with an indexed bogey portfolio of legally acceptable equities, comparable funds, universes, and indexes.

(4) Returns as credited to employer accounts.

(5) Returns as reported in annual reports.

(6) Returns as reported by the Controller.

(e) A transaction summary which shall adequately review the system's custodial relationship and daily cash management, purchases, sales, turnover, private placements, soft dollar purchases, and transaction costs such as commissions, dealer spreads and accommodations.

(f) An explanation of the use by the system of outside investment advisers and managers and any participation in corporate annual meetings and shareholder voting.

(g) An outline of the basis of the employer contribution rate and the sensitivity of the rate and the funded status of the system to economic assumptions, actuarial methodology, decrement assumptions, and benefits and the reasons for any changes in the employer contribution rate from the previous year and projections of future employer contribution rates and funded status for the next 20 years, given various actuarial assumptions.

SEC. 10. Section 22218.7 is added to the Education Code, to read:

22218.7. The board shall submit a review of the system's assets to the Legislature on a quarterly basis which report shall:

(a) Discuss the system's portfolio and contain the following information:

(1) Concentration, current holdings at cost and market value, risk characteristics (R-squared, Beta, standard error), fundamentals (P/E, dividend yield, measures of growth, size, earnings quality, debt/equity) of equities.

(2) Concentration, current holdings at cost and market value, maturity, duration, quality, coupon, and current yield of fixed income instruments.

(3) Current holdings at cost and market value of real estate equities.

(4) Current holdings at cost and market value of mortgages.

(5) Securities lending activity.

(6) Options and forward commitments.

(7) Cash and cash equivalents.

(b) Disclose the following information on the rate of return of the fund by type of asset:

(1) Time-weighted return on a five-year, three-year, two-year, one-year, six-month and three-month annualized basis.

(2) Dollar-weighted return on a five-year, three-year, two-year, one-year, six-month and three-month annualized basis.

(3) Summary of performance of an indexed portfolio containing all legal investments and performance of comparable universes and other indexes.

(c) Include a performance review of asset allocation, of equities due to market timing, sector selection, stock selection and trading, of fixed income instruments due to interest rate anticipation skills, credit analysis, sector trading and swapping and of value added over indexing (alpha).

(d) A review of the system's custodial relationship and daily cash management and a summary of the system's investment transactions, including purchases, sales, turnover, private placements, soft dollar purchases, and transaction costs such as commissions, dealer spreads and accommodations.

(e) A review of the role of any outside managers and advisers, stockholder voting, and changes in investment staff or reorganization.

Footnotes

1. Technical Appendix, *Coming of Age: Toward a Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 587. See also, *Pension Task Force Report on Public Employee Retirement Systems*, House Committee on Education and Labor, as Cong. 2 sess. (GPO, March 15, 1978), p. 51.
2. *Task Force Report*, op. cit., p. 51.
3. Ibid., p. 53.
4. Data supplied by Howard Winklevoss & Associates to President's Commission on Pension Policy. See also, Preston, C. Bassett, "State and Local Pension Plans," in Technical Appendix, *Coming of Age: Toward a Retirement Income Policy*, President's Commission on Pension Policy, 1981, pp. 590-610.
5. *Task Force Report*, Table B5, pp. 56-57.
6. Ibid., p. 57.
7. Ibid., p. 62.
8. Ibid., p. 188.
9. Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management* (Twentieth Century Fund, 1976), pp. 9-10.
10. *Task Force Report*, p. 190.
11. See, Marcy Avrin, "Pension Fund Investment Decisions: Structural Reform," June 23, 1982; "Pension Fund Budget Decisions: Procedural Reform," September 13, 1982; "Investment Performance," November 30, 1982; all reports to the Joint Committee on Pension Fund Investment, Avrin Economics, Inc., 1982.
12. Avrin, "Pension Fund Investment Decisions," op. cit., p. 1.
13. See letter of Dan D. Lanoff to Louis Paper, Chairman, Joint Committee on Public Pension Fund Investments, June 17, 1983.
14. See letter of Governor Deukmejian to Louis Paper, July 28, 1983.
15. See statement of Francis R. Spaniola before the United States Senate Subcommittee on Savings, Pensions, and Investment Policy hearings on S. 2106, March 29, 1982, Washington, D.C.
16. Kohlmeier, op. cit., pp. 9-10.
17. *Task Force Report*, op. cit., p. 3.
18. John Peterson, "Public Pension System Financial Disclosure," Municipal Finance Officers Association, May, 1980, p. 3.

19. Ibid., p. 3.
20. See *Coming of Age: Toward a National Retirement Income Policy*, final report of the President's Commission on Pension Policy, February, 1981, p. 46.
21. Roy Schotland, Statement before the U.S. Senate Subcommittee on Savings, Pensions, and Investment Policy, hearings on S. 2106, March 29, 1982, Washington, D.C.
22. Schotland, op. cit., p. 9.

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How Much Federal Regulation do Public Funds Need?

ATTACHMENT B

by Michael T. Leibig
and Robert W. Kalman

The unregulated control by plan managers and the private financial community over the $110 billion in public pension fund assets and the lack of adequate public pension plan reporting and disclosure demand urgent reform.[1] Conflicts of interest and inadequate reporting and disclosure, unfortunately, are the rule among the more than 6,000 state and local pension plans.

Claims to the contrary are extremely misleading. In a recent editorial in a prominent pension journal, for example, Carmen Elio, Director of the Massachusetts Retirement Law Commission, claimed that "tremendous progress" has been made in the area. He suggests that the remaining problems will best be solved by the "velvet glove" of the private financial community, rather than the "sledgehammer" of federal legislation.[2] Such claims are refuted by the facts.

Conflicts of interest

In a widely cited study of the asset management practices of state and local pension funds, Louis Kohlmeier documents the widespread nature of conflicts of interest that exist in public employee pension plans.[3]

Kohlmeier demonstrated that to a "considerable degree [public pension funds] are controlled by city and state employers." He has shown that of the $93.5 billion (1974 value of assets) held by public pension funds, much is managed in the interests of those who control the funds rather than in the interests of those whom the funds are intended to benefit.[4]

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[1] Bureau of the Census, U.S. Department of Commerce, *Finances of Selected Public Employee Retirement Systems*, Quarterly Report, December 1977.

[2] Carmen Elio, "Public Reporting and Disclosure," Guest Editorial, *Pension World*, December 1977, p. 3.

[3] Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management* (New York Twentieth Century Fund, 1976).

Establishing statutes

Statutes which establish state and local pension funds usually create a board of pension fund trustees. Most often, the trustees are appointed by an elected official; typically they are charged both with fund administration and investment management. "Most frequently, the boards are composed largely or exclusively of public officials, lawyer representatives, and others who are not professionally trained to invest large sums of money."[5] Typically, professionals are not on the board of trustees. Money managers, usually banks, are used.[6]

Ho do these pension trustees rate as "managers"? The Congressional Pension Task Force found that the standards which plan officials must meet in their conduct are vague. The Task Force observed in its 1976 *Interim Report* that:

> . . . public plans in general do not appear to be operated within the general financial and accounting parameters established by custom and practice [and now by ERISA] in the private pension retirement plan field. *The absence of any external independent review has perpetuated a level of employer control and attendant potential for abuse unknown in the private sector.* [Emphasis supplied.][7]

In 1977, Greenwich Research Associates carefully reviewed over 150 of the largest public sector funds and found major problems in their management. The report concluded:

> Forty-eight percent of the public pension funds report they have problems with their investment manager, and some of the problems they have with their own managers are those they would consider most harmful: portfolio managers don't give each account the individual attention it deserves; managers don't keep clients properly informed between meetings; investment review meetings and written material are too superficial; and portfolio managers are changed too often.[8]

Kohlmeier has pointed out that the most fundamental question in this area is, whose interests come first: the pension beneficiaries, the employers, or the investment managers?

> [The] possibilities for conflicts are numerous. For example, some trustees and their staffs decide how the brokerage commissions generated by the fund's portfolio transactions will be allocated; and when they make these decisions, it appears that the commission business is often channeled to favored regional broker-dealers with political influence or friends in the state or city government. But when investment advisors decide where portfolio securities will be bought and sold, other conflict questions arise—for example, when the einvestment advisor is a bank having commercial relationships with broker-dealers to whom it allocates brokerage business. Almost all public pension funds appear to allow their investment advisors to obtain research from broker-dealers through "soft dollar" payments—that is, in exchange for commission business. But few if any pension funds have established controls to ensure that soft dollar benefits obtained by investment advisors accrue to the benefit of the pension funds paying the transaction costs rather than the benefit of the advisors' other customers . . . *[If] pension fund trustees and staffs fail to equip themselves with more sophisticated money management techniques and with more effective surveillance of their hired money managers, conflict-of-interest problems—and abuses—will also continue to proliferate.* [Emphasis supplied.][9]

Boards of pension trustees have too often ignored funding and investment requirements. Kohlmeier describes abusive situations in Illinois, Maryland, New Jersey, Philadelphia, Los Angeles, Virginia, Maine, Nevada, Georgia, North Carolina and other areas.

It is clear that the "velvet glove" of the private sector financial community too often hides a grasping hand and that the frequent tie between banks or private financial managers and public funds endangers the funds' position. Investment decisions are motivated by the investment needs of those controlling public pension funds, rather than the security needs of the consumers of public pensions—plan participants and beneficiaries.

Too often, public funds, on the advice of the private financial community, invest a disproportionate share of their assets in local mortgages or unwisely concentrate investments in other ways. Largely inexperienced public pension fund administrators, especially those of smaller funds, must rely on such advice, intensifying these problems.[10]

Reporting and disclosure

Equally as important as conflict of interest problems is the degree to which secrecy and lack of public disclosure dominate the public pension area.[11] In fact, Kohlmeier found that conflicts of interest problems:

> . . . are compounded by the general failure of public pension funds to make full public disclosure of how investment authority is divided and the

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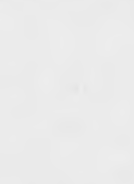
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[4] *Ibid.*, p. 11.

[5] *Ibid.*, p. 9.

[6] See Note, "Public Employee Pensions in Times of Fiscal Distress," 90 *Harv. L. Rev.* 992 (1977) pp. 1013 through 1116 on the selection of trustees and the relative merits of governmental officials, union representatives and "neutrals" on boards of trustees.

[7] Pension Task Force, Subcommittee on Labor Standards, Committee on Education and Labor, U.S. House of Representatives, 94th Congress, Second Session, *Interim Report of Activities* (Washington, D.C.: U.S. Government Printing Office, 1976), p. v.

[8] *Public Pension Fund Trustees Reports* (Greenwich Research Associates, 1977), p. 17.

[9] Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management*, pp. 9 and 10; See also A. H. Raskin, "Pension Trustees Juggling Inherent Interest Conflicts." *The New York Times*, March 16, 1977.

methods by which depository banks, investment advisors, and broker-dealers are selected . . . Control and surveillance can minimize the effects of conflicts. And in itself, greater disclosure should help prevent the unavoidable conflicts from growing into situations that are harmful to both pension fund beneficiaries and the general public, which must ultimately pay the bills.[12]

The preliminary results of the Congressional Task Force study of public pension plans show that:

—Almost *half* of the 800 plans surveyed do not regularly distribute plan description booklets to participants, including more than 25 per cent of plans with more than 1,000 participants.

—60 to 70 per cent of all state and local systems do not disclose (or know) the market value of plan assets; of those that do, about 40 per cent show a market value of less than 90 per cent of book value.

—25 percent of all state and local plans have *never* had an actuarial valuation and about *one-third* have not had one within the last five years.

—Nearly one-third of large state and local plans are never audited by a certified public accountant.

—Public retirement systems suffer from other serious deficiences in disclosing plan information to participants and beneficiaries.

—Because of the absence of disclosure, plan participants and beneficiaries seldom know their pension entitlements, let alone how to object to the practices involving the management of plan assets.[12]

Kohlmeier's study reinforced these conclusions. He found that:

> Most public pension funds make financial reports of some kind to the legislature, to the governor or mayor, to employees and/or to the general public. The great majority of such disclosures are wholly inadequate to allow legislators, employees or the public to judge the adequacy of fund administration . . . Rarely do reports disclose individual [investment information capable of being analyzed].[14]

Few, if any, public pension systems provide for regular, meaningful reporting and disclosure. Often the data necessary for such disclosure are unavailable, even to the asset managers. Detailed investment studies are rare; actuarial reports, on a regularly updated basis, are neglected.

The problem with secrecy concerning basic information of public pension systems is not limited to backward, small or outmoded plans. Confidentiality and the privacy rights of plan participants are, at times, relied upon to prevent reporting and disclosure of even general or aggregate information about a plan's finances, its actuarial health, or the cost of plan amendments. This is so even when the request for such information comes directly from plan participants or their representatives.

For example, the problem of limited disclosure infects even "reforms." In April 1977, the Department of Labor announced a $200,000 contract with the Massachusetts Retirement Law Commission to establish a New England Retirement Law Council to do a study of public pension systems within the six New England states. The eighteen month study aims at coordinating a network of pension plans and establishing a computer data bank. The Department of Labor has announced that the New England Council "will create a complete data base on the characteristics, funding status, and coverage of all public pension systems within the boundaries of the six New England states." It is planned that the computer program developed will, among other things, be equipped to calculate the cost of any proposed change in a public pension system in New England.

There is no question that such a system established with federal funds, and on the basis of expert actuarial service, is a real public pension reform. As things currently look, however, even this new developing reform system has a fatal problem. The information developed by the Commission is to be in the complete control of the executive and legislative departments of the jurisdictions involved. While an initial report will go to the Department of Labor, access to the use of the data bank will be severely restricted. Labor unions, taxpayer representatives, participant and beneficiary representatives, and independent researchers are not currently anticipated to have access to the data bank. This will be the case even when these outside groups offer to pay the cost of a specific answer to a general question such as the cost of integrating a system with Social Security.

The program's Advisory Committee chaired by Alicia Munneil has discussed the problem and the importance of full reporting and disclosure with Director Carmen Elio. Furthermore, the initial unsolicited proposal to the Department of Labor described the program as providing the basis for full reporting and disclosure. However, unless something is changed before the eighteen month study is completed, only those now controlling access to the information about the systems involved will have access to the new computer program.[13a]

Legal remedies

It would be misleading to leave the impression that there are no legal remedies for fiduciary abuse of public pension plans. This would imply that no recourse exists ot plan participants faced with lack of disclosure or secrecy.

For the most part, private remedies are technically available. Common law and, often, statutory fiduciary protections frequently do exist. State freedom of information and consumer protection systems are available.

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[10] *Ibid.*, pp. 11-26. As one part of the Congressional public pension study mandated by ERISA, the Senate participants in the Joint Pension Task Force have requested that the General Accounting Office make a study of pension asset management practices in six states, following the Kohlmeier format. The results of this study, however, are not yet available.

[11] See Robert Blixt, *Pension World*, December 1976, pp. 3-4.

[12] Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management*, pp. 9 and 10.

[13] See Russell Mueller, Actuary for the Congressional Pension Task Force, "Public Pensions," address before the American Council of Life Insurance, November 1, 1977; Howard Kline, Counsel to the House Pension Task Force, address to National Conference on Public Employee Retirement Systems, March 23, 1977; and "Public Pension Reform," *Pensions and Investments*, June 6, 1977, p. 11.

[13a] See "New England Pension System Study Contract Awarded," *BNA Pension Reporter*, May 23, 1978, p. A-3; see also correspondence between Leibig and Kalman and the Department of Labor, May 11, 1977, May 18, 1977, and June 8, 1977; see also New England Retirement Law Council letter to Kalman, July 12, 1977.

[14] Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management*, p. 54.

Remedies cumbersome

These remedies, however, are cumbersome and expensive. They are not designed to provide specific remedies to pension participant or beneficiary problems. Fiduciary duty litigation against the state systems face difficult separation of power and sovereign immunity problems. For the most part, these problems cannot be overcome without sophisticated, expensive legal skills.

Three particular problems without easy solution are: (A) application of traditional fiduciary standards and "prudent man" rules in the public sector; (B) refusal of the government to fund a plan as required; and (C) investment of public pension funds in governmental securities.

Fiduciary problem

It is generally believed, and may be generally accurate, that public pension plans must be managed for the benefit of participants and beneficiaries according to the same fiduciary standards that control private pension funds. As a technical, legal point, this may be more difficult to establish than at first appears. Efforts to enforce traditional fiduciary obligations against decisionmakers and trust managers must overcome sovereign immunity and separation of power defenses. It must then be established that the plan is indeed a trust, designed to be managed for the exclusive and sole interest of participants and beneficiaries.

Difficulties in establishing

Depending on the statute involved, this may be relatively easy or very complicated to prove. There may be no specific "fund" involved in the plan. It may be far from apparent that public pension participants and beneficiaries have equitable title in a public pension fund. Furthermore, no explicit declaration of trust with respect to the fund's assets may exist. It may also be difficult to establish clearly that plan assets are, in fact, a separate trust fund rather than a simple division of the budget or accounts of the governmental employer involved.

Even if it is established that a trust fund does exist and that fiduciary duties do apply, the specific duties of plan fiduciaries may remain in question. Public fund fiduciary duties may vary considerably from those of private trust fund fiduciaries. Statutory provisions may exist, providing that any investment gains must be returned to the general fund of the government. Trustees may not be obligated to consider investment return against risk.[13]

A statute may also impose requirements to invest in governmental securities or securities of businesses within the jurisdiction. Other statutory requirements may change traditional rules of diversification of trust assets. Traditional prudent man rules may be relaxed somewhat during situations of grave financial crisis.[14]

In *Withers, et al. v. Teachers Retirement System of the City of New York, et al.*, 76 Civ. 4474 (WCC) (S.D.N.Y., 1978) a federal District Court in New York recently found that public fund trustees did not breach fiduciary duties by investing in employer bonds when the employer was thought to be on the brink of

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bankruptcy. The court concluded—

> "[that the trustees' initial] hesitation as to the quality of the bonds and the undesirability of committing so large a proportion of the fund's assets to a single class of security was outweighed by what they conceived as their paramount obligation to insure the survival of the fund."

This is contrary to the general rule applied to private pension trusts in *Blankenship v. Boyle*, 329 F. Supp. 1089 (D.D.C., 1971) which held that pension trustees should not consider the interest of employees and pension participants in maintaining the economic strength of the employer when making pension investments.

Enforcement

On a number of occasions, governmental employers have failed to fund their plans in line with the statutory requirements:

> Courts have uniformly held these missed appropriations to be contract violations. Depending on their view of the applicable doctrines of separation of powers and sovereign immunity, the states' courts have adopted various responses to requests that they order the state legislator or state executive actually to make the appropriations [needed to fund the plan].[17]

In *Dombrowski v. The City of Philadelphia*, for example, the court ordered the City to put its pension plan on an actuarially sound basis.[18] In Illinois, a court agreed that failure to fund a public plan is illegal. However a separation of power argument convinced the court that no such order was permissable. Therefore, only a declaratory judgment resulted.[19]

Investment

Some statutes require public pension plans to invest a certain portion of their assets in governmental securities. The pros and cons of such requirements have been developed in detail by the *Harvard Law Review*. Under the Harvard analysis, trustees making the investment might properly look beyond the direct security interests of active plan participants and beneficiaries. They also might consider their own interest in the stability of the government sponsoring the pension plan; the security interests of active plan participants, exclusive of the interests of beneficiaries; and the general interests of beneficiaries and participants in avoiding governmental bankruptcy.[20]

Investments of this type should be considered highly suspect. They should be opposed unless made after all ramifications of these investments are fully and carefully considered.

In the recent New York fiscal crisis, very careful consideration of all elements of the decision was made prior to City pension fund investment in New York securities. Special legislative approval and adjustments of fiduciary requirements were granted; special and specific Federal policy and tax decisions were made which protected the funds.[21]

Conclusion

Conflicts of interest in the management of public pension plans and their assets present a major challenge for reform. At the heart of the problem is the disinterest and lack of understanding by public plan managers, participants and beneficiaries, their representatives, and the taxpaying public.

Consumers of public pensions have no active enforcement advocate. No one can control or effectively challenge self-dealing and poor management. There is no agency with adequate authority to demand full, meaningful, and understandable reporting and disclosure comparable to the ones that oversee private plans.

Technical, legal avenues adequate to secure complete information about public pension plans are expensive and complicated. Meaningful access to private legal remedies to these problems does not exist. The disinterest of the past generated present problems. Pension plan participants and beneficiaries and the taxpaying public deserve better.

Public reporting

This is the real world of public sector reporting and disclosure and asset management. Public pension reform is needed in this area. The argument for reform is stronger than the private sector argument which resulted in ERISA. Abuses are widespread; employer and private financial community control is disturbing; plan participant and taxpayer knowledge is kept to a minimum. Views to the contrary, citing "tremendous progress" through the "velvet glove" of the private financial community do not match the facts. They represent a myopic perception of the disturbing reality of reporting, disclosure, and conflicts of interest in the public sector today. ☐

This article is based on a chapter from a forthcoming book on the reform of public pension plans. The book is tentatively entitled *The Public Pension Crisis: Myth, Reality, Reform.* Publication is scheduled later this year by the American Federation of State, County and Municipal Employees.

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[15] Report of the New York State Permanent Commission on Public Employee Pension and Retirement Systems, *Financing The Public Pension Systems, Part I: Actuarial Assumptions and Funding Policies*, March 1975, pp. 34-35.

[16] See also 90 *Harv. L. Rev.* 992 (1977).

[17] 90 *Harv. L. Rev.* 992 (1977), p. 1006.

[18] 254 A. 2d 238 (1968).

[19] *Illinois Education Association v. Illinois*, No. 6891 (Ct. Cl. June 25, 1973); see also *Weaver v. Evans*, 495 P. 2d 639 (1972) (*en banc.*)

[20] 90 *Harv. L. Rev.* 992 (1977).

[21] See American Bar Association, *1976 Labor Relations Law Committee Reports*, (1976), pp. 416 and 417; Agreement between Municipal Assistance Corporation, N.Y. Banks and the City of New York, November 26, 1975; New York State Statute on indemnification and fiduciary obligations, 1975, N.Y. Laws, Chap. 890; New York Seasonal Financing Act and its legislative history, P.L. 94-143 (Dec. 9, 1975); special amendment to Internal Revenue Code Section 401(a) and its legislative history, P.L. 94-236 (March 19, 1976); 90 *Harv. L. Rev.* 994 (1977) pp. 1005-1016; Michael S. Gordon, "The Politics and Perils of Reforming Public Employee Pension Plans," *Employee Benefits Journal*, Fall 1976, pp. 5 and 6; *Withers, et al. v. Teachers Retirement System of the City of New York, et al.*, 76 Civ. 4474 (WCC) (S.D.N.Y.); and International Foundation of Employee Benefit Plans, "Public Fund Trustees Did Not Breach Fiduciary Duty in Investing in New York City Bonds," *Legal-Legislative Reporter, News Bulletin*, (June 1978), pp. 6 and 7.

Federal Toward State Benign Neglect

by Michael T. Leibig and
Robert W. Kalman

The federal government is uninvolved in, but has a responsibility for, the regulation of state and local pension plans. Until recently, little attention has focused on federal programs and policy which influence non-federal public pension plans. Major statutory responsibilities have long been ignored. Not knowing what action to take, federal agencies have done nothing, even after officially recognizing their obligation to act. The assumptions that state and local plans "are not covered by ERISA," are unaffected by other current federal regulation, and are beyond the constitutional reach of any federal regulation or responsibility have been accepted without examination.

Federal Government Involved

None of these assumptions is well founded. Federal tax policy, jobs programs, anti-fraud securities law, fiduciary responsibility rules, Social Security programs, policies toward the state and local government fiscal crisis, urban programs, and related activities have necessarily immersed the federal government in the regulation of state and local pension plans. For the most part, however, the federal government has been neglecting its existing responsibilities.

The first step in any national public pension reform movement requires that the federal government recognize and take seriously its current public pension responsibilities. The second step is to redesign federal programs so that they effectively achieve the policy goals which initiated the federal government's involvement in state and local pension plans.

A realistic approach to federal policies toward state and local pensions requires an assessment of the following: (1) The constitutional strictures of *The National League of Cities v. Usery* Supreme Court decision; (2) The Internal Revenue Service's public pension obligations; (3) The Department of Labor's policies and programs toward public pensions; and (4) Other areas of federal involvement, especially those designed to prevent fraud or enforce fiduciary duties.

I. THE CONSTITUTIONAL QUESTION: THE NATIONAL LEAGUE OF CITIES V. USERY

In *The National League of Cities v. Usery* and *California v. Usery*, the United States Supreme Court ruled in 1976 that Congress exceeded its authority under the Commerce Clause of the United States Constitution when it enacted legislation extending mandatory minimum wage and overtime provisions of the Fair Labor Standards Act to almost all state and local government employees.[1]

Since *The National League of Cities* decision, the debate over federal action to reform state and local pensions is too often sidetracked by the issue of Congress's authority to legislate in the area.[2]

Analysis of this issue must recog-

This article is based on a chapter from a forthcoming book on the reform of public employee pension plans. The book is tentatively entitled The Public Pension Crisis: Myth, Reality, Reform. *It will be published later this year by the American Federation of State, County and Municipal Employees.*

[1] *The National League of Cities v. Usery* and *California v. Usery*, U.S. Supreme Court, No. 74-878, 44 Law Week 4977, June 24, 1976; See Michael Gordon, "The Politics and Perils of Reforming Public Employee Pension Plans," EMPLOYEE BENEFITS JOURNAL, fall 1976, pp. 2-7 and 32-33; and 93 *BNA Pension Reporter*, July 5, 1976, P. A-17.

[2] See, for example, Gordon, note 1, above, and Dallas Salisbury, "Public Employee Benefit Plan Reform: A Non-Legislative Alternative," EMPLOYEE BENEFITS JOURNAL, fall 1977, pp. 6-11 and 27.

ATTACHMENT C

Policies and Local Pensions: or Negligence?

nize the extent of federal power and responsibility remaining after the decision. Three points are especially important:

- Congressional regulation of state and local activity based on the spending power, the taxing power, the Fourteenth Amendment, or other non-commerce powers present no *National League of Cities* problem.
- Congressional regulation or guidelines which are not mandatory present no *National League of Cities* problem.
- Even in cases where *The National League of Cities* issue is suggested, the question is one of whether a direct displacement of state sovereignty has occurred. Unless Congress acts under the Commerce Clause "to directly displace state freedom to structure integral operation in areas of traditional governmental functions." *The National League of Cities* case is not a problem.

No Plans or Levels Mandated

No system of public employee pension reform would mandate either the existence of a state or local pension program or the level of pension benefits provided. A state or local government is free, of course, to determine by itself what pension benefits it provides. The issue is whether a reform system should be established which would insure that benefits promised under a voluntarily adopted pension plan are paid, and whether the plan operates without discrimination, dishonesty, or abuse.

Consideration of federal public pension reform raises different issues, depending on the scope of reform discussed. Reform of reporting and disclosure requirements is different from reforms which also inclu[illegible] strict fiduciary standards; which is quite different again from reform which adds participation, vesting, and benefit accrual rules; which is still different from adding mandatory funding requirements. Furthermore, reforms which require that a plan meet standards to qualify for a special tax treatment or other federal benefits differ from mandatory systems which seek enforcement through civil, or even criminal, penalties.[3]

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[3] In *North Carolina v. Califano*, the United States Supreme Court unanimously affirmed

Michael T. Leibig

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Robert W. Kalman

Public pension reform consistent with *The National League of Cities* decision can clearly be achieved in most, if not all, of these areas.

The fact that the federal government can play an active role in the reform of public pension plans is attested to by the federal government's current involvement in the regulation of these plans.

II. *THE PUBLIC PENSION OBLIGATIONS OF THE INTERNAL REVENUE SERVICE*

A. *The IRS and Plan Qualification*

The Internal Revenue Code contains a system of tax qualification requirements applicable to state and local pension plans—a sophisticated federal system of regulating public employee pension trusts under Internal Revenue Code Sections 401 (a) and 501 (a).

The IRS administers this system of rules, which requires that pension plans meet standards in order to qualify for special tax treatment. Employee pension trusts are not tax exempt, nor are contributions to them deductible from gross income, unless the trust is part of the pension plan which qualifies under the provisions of Sections 401 and 501 of the Internal Revenue Code. While ERISA contains a provision exempting "governmental plans" from participation, vesting, funding, disclosure, and fiduciary standards, no such exemption exists in the antidiscrimination, prohibited practice, or other pre-ERISA regulations.[4]

The IRS ruled in 1972 that a state teachers' retirement trust fund was entitled to special benefits under Section 401 (a) only if it met the requirements, and complied with regulations, under that section.[5] The IRS has, until very recently, consistently maintained this position.

Daniel Halperin, Tax Legislative Counsel to the Assistant Secretary of the Treasury for Tax Policy, recently testified before the Senate Finance Committee that:

> It is well established that a trust or other 'arrangement funding a retirement plan is tax-exempt if the plan meets the qualification requirements of the Internal Revenue Code, including the condition that the plan not discriminate in favor of higher paid employees. This applies whether the employer maintaining a plan is a governmental body, a tax-exempt organization, or a taxable corporation. Whether or not the plan is qualified also has a very important bearing on the taxation of the employees participating in the plan. If the plan is qualified, employees are taxable only as employer contributions are distributed or made available to them. Furthermore, the distribution may be subject to more favorable tax treatment than other types of income. For example, special ten-year averaging is available for a lump sum distribution. In addition, a death benefit may not be subject to estate tax. On the other hand, if the plan is not qualified, an employee is taxable on employer contributions when those contributions are vested (i.e., they cease to be subject to a substantial risk of forfeiture). Thus, for example, if an employee is fully vested in employer-derived benefits under a plan, contributions by the employer are taxable to the employee at the time the contributions are made.[6]

"The Power to Tax . . ."

The income of a government or a governmental entity is generally exempt from federal taxation under Section 115 of the Internal Revenue Code. The 1972 tax ruling recognized that when a pension trust fund is established, it belongs to plan participants and is not the property of the government. Therefore, the trust must qualify for special tax support as do other pension trust funds.[7]

The most important of the tax qualification rules require a plan not to discriminate in favor of officers, shareholders, supervisors, or highly compensated employees, and not to engage in certain specifically enumerated "prohibited transactions" between the trust and "disqualified person" (which includes fiduciaries, employees, and others). The prohibited transactions regulations are designed to prevent self-dealing. These rules, when enforced, prevent pension plans from being manipulated unfairly in favor of highly compensated employees or selfish plan managers and decision makers. They are intended to prevent the abuse of the pension trust device as a tax shel-

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a lower federal court's rejection of a *National League of Cities* based constitutional attack on requirements of the National Health Planning and Resources Development Act of 1974, 42 U.S.C. §300k et seq., that any state, in order to qualify for financial grants under federal health programs, must have a certificate of need program, applicable to both public and private health facilities, under which "only those services, facilities, and organizations found to be needed shall be offered or developed in the State"; even though North Carolina Constitution, as construed by state Supreme Court, forbids the certificate of need mechanism and, therefore, requires amendment to permit compliance with act and to avoid loss of about $50 million in federal aid. *North Carolina v. Califano*, No. 77-971, aff'd, 46 U.S.L.W. 3949 (U.S. April 18, 1978).

[4] See section below on ERISA and "Governmental Plans," and note 20, below.

[5] See Revenue Ruling 72-14 (1972).

[6] Statement of Daniel Halperin, Tax Legislative Counsel, Office of Assistant Secretary of the Treasury for Tax Policy, before the Senate Finance Committee, Subcommittee on Private Pension Plans and Employee Fringe Benefits, Committee on Finance, United States Senate, March 15, 1978, p. 2.

[7] A separate trust designed to be managed in the sole interest and for the exclusive benefit of participants and beneficiaries may not always exist. Depending on the public pension plan and state law involved, the existence of a trust may be a simple or a very complicated matter to establish. There may, in some cases, be no specific "fund" involved. It may be far from apparent that public pension participants and beneficiaries have equitable title in a public pension fund. Furthermore, there may be no explicit declaration of trust with respect to the fund's assets. It may also be difficult to establish clearly that plan assets are, in fact, a separate trust fund rather than a simple division of the budget or accounts of the governmental employer involved. Where a separate trust does exist, however, the problem of the Section 115 exemption should not be a major obstacle to federal tax enforcement.

ter.[8] The protections they afford are valuable to participants, whether public or private employees.

Technically, the 1972 IRS Ruling should have had a tremendous impact on public pension plans. However, the exempt status of governments and the fact that the prohibited transaction and discrimination rules were designed primarily to deal with corporate pension plans create an environment of unreality in their application by IRS to public plans.

The governmental tax exemption causes a particularly difficult enforcement problem. It removes one important motivation for compliance with the regulations which exists in the private sector. Private employers are responsive to the rules, partly because non-compliance could affect their own tax liability. In the public sector, however, this is not a factor. The IRS must threaten to tax either the individual participants and beneficiaries, whom the rules are designed to protect, or a trust fund which, because of its relationship with a government, is difficult to pursue.[9]

Rule Enforcement Neglected for Public Plans

Generally, the enforcement of these rules has been neglected in the public sector. Except when the question is formally raised, the IRS apparently follows a policy of benign neglect.

Robert Tilove discussed the problem in ***Public Employee Pension Funds***:

> Some difficulty arises when rules designed for corporate pension plans are applied to public plans. However, with rare and only very recent exception, the rules have in fact not been applied, except when question has been formally raised. The answer is given, at least in the first instance, by the local director of the Internal Revenue Service. Consequently, answers differ from one state to another, as is to be expected when a complex set of rules written to assure even-handed treatment of corporate executives and the rank-and-file in private industry is applied to public plans. Many public systems have never asked for rulings as to whether their plans qualify; they and their members have simply assumed that there is no problem.
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> Nonenforcement by the Internal Revenue Service has in fact been the rule. If enforcement were attempted, it would confront the question whether to assess most state and local judges for thousands of dollars of back taxes because of their superior benefits. Awkwardness has arisen—at least until 1975—only for those system trustees or officials meticulous enough to ask for a ruling.[10]

According to preliminary findings of the Congressional Pension Task Force, four out of five state and local retirement systems are either unfamiliar with the application of Section 401(a) to public plans or, knowing of the rule, have ignored it. No more than 15% of all plans have *ever* received favorable plan qualification determination letters from IRS.[11]

One Tax Collector Adamant

The IRS policy toward enforcement has been inconsistent. The St. Louis IRS district office is probably the most adamant regional advocate of enforcement of public plan tax qualification rules. Since 1971, the St. Louis office has collected taxes on a firemen's pension plan from the City of St. Joseph, Mo. because, according to press reports, "the plan refuses to submit to qualification."[12]

The fund's accountant, Jerry Moog, has argued that the plan is immune from taxes under the intergovernmental tax immunity rule of Section 115 of the Internal Revenue Code. The IRS responded that once governmental money is deposited in a pension trust, it is no longer public money and, hence, can be taxed. So, every year the St. Joseph, Mo. Firemen's Pension Fund pays taxes and files for tax refunds, which are denied.[13]

A number of other plans in Missouri, including plans for the cities of Joplin, Springfield, Kansas City, and Columbia report similar experiences. Apparently no IRS office, other than the St. Louis district office, has been attentive to the problem of tax qualification in public pension funds.[14]

In August 1977, the IRS announced a "review" of "issues concerning discrimination and the taxability of income of trusts relating to state and local government employee retirement plans." The Service stated that "Pending completion of the review, the IRS will resolve these issues in favor of the taxpayer or governmental unit."[15]

B. *The IRS and Plan Disclosure*

On April 21, 1977, the IRS announced that public pension plans must file annual reports. Form 5500 and 5500-C, the Annual Return/Report of Employee Benefit Plans, would be required, whether or not the plan had received or applied for a determination of tax qualification. Some of the provisions of ERISA specifically do not apply to governmental plans. The provisions which are not applicable were indicated as such in the instructions.[16]

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[8] See Federal Tax Regulations, (U.S. Code, Congressional and Administrative News, 1978), Vol. I, Sections 1.401-4, 1.402(a) and 1.503(b).

[9] See note 6, above.

[10] Robert Tilove, *Public Employee Pension Funds*, (New York: Columbia University Press, 1976), p. 248f.

[11] Russell Mueller, "Public Pensions," an address before the American Council of Life Insurance Conference, Reston, Va., November 1, 1977, p. 11.

[12] Natalie DeViney, "Disparate IRS Positions on Qualifying Confuse Public Funds," *Pensions and Investments*, March 28, 1977; see also Les Stern, "Public Pension Plans Feel Heat From IRS," *Pensions and Investments*, June 6, 1977.

[13] *Ibid.*

[14] *Ibid.*

[15] U.S. Department of Treasury, Internal Revenue Service, News Release, IR-1869, August 10, 1977.

The *Compensation Planning Journal* reported in its May 1978 edition that "A

Note: Final regulations requiring funded deferred compensation plans (including governmental and church plans, whether or not qualified) to file annual reports were issued by the IRS on July 7, 1978. See 43 *Fed. Reg.* 29291, July 7, 1978.

The IRS reporting requirement has a sound legal basis. Michael Gordon, a private attorney who contributed to the writing of ERISA legislation as an aide to Senator Jacob Javits, has reviewed the legislative history of ERISA. He agrees that IRS reporting requirements must be applied to public plans.[17]

Many public plan managers, employers and money managers objected to the IRS reporting requirements.[18]

On August 18, 1977, the IRS extended until December 31, 1977 the deadline for filing these reports. The information required by the forms was also significantly reduced. Only initial information identifying the plan and answers to one or two other basic questions are requested.[19] Even the reduced requirements met strenuous objections from some plan administrators.[20]

C. *IRS and Public Pensions: A Summary*

The tax qualification and reporting and disclosure requirements administered by IRS are designed to insure special tax treatment only of those pension plans which meet certain federal requirements. These requirements prevent discrimination in favor of highly paid individuals and prohibit abuse by those in control. The enforcement of such rules in a pragmatic, realistic way would be a major step forward for public pension reform.

Public employer and money manager interests exaggerate the consequence of meeting a simple reporting and disclosure requirement. Furthermore, the reporting and qualification standards exist in order to achieve a clearly proper federal policy; that is, tax policy support for retirement income security. These tax policies were developed for the retirement security of working Americans, and should be administered primarily with a view toward such protection.

The IRS qualification standards should be reformed to reflect more adequately the true conditions and problems of public plans. The IRS has neglected its responsibilities to public plan participants.

The tax policies which current qualification standards were designed to carry out can be protected in the public sector by realistic and modern standards, designed expressly for public plans. Such standards lie within the authority of IRS and could be issued as part of the current standards for private plans.[21]

The confusion and neglect of the federal government's application of the Internal Revenue Code to state and local plans become even more distressing when the application of ERISA to public plans is analyzed.

III. *THE PUBLIC PENSION PROBLEMS OF THE U.S. DEPARTMENT OF LABOR*

A. *ERISA and Definitional Confusion*

ERISA is "jointly administered" by the Department of Labor and the IRS.

Section 4 of ERISA exempts "governmental plans" from coverage under Title I of the act, which contains employee benefit protection provisions administered by the Department of Labor. Title II and Title III must be analyzed on a section-by-section basis to determine which sections contain an exclusion.[22]

Section 3031 of ERISA provides for a Congressional study of "retirement plans established and maintained or financed (directly or indirectly) by the government of the United States, any state government division thereof, or by any agency or instrumentality of any of the foregoing." The provisions of ERISA have resulted in the widely held belief that ERISA does not affect public pension plans. Much of ERISA,

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unwritten rule has existed over the years to the effect that the Internal Revenue Service would generally be more lenient in considering whether retirement plans of state and local governments constitute qualified plans under IRC Section 401(a). Status as a qualified plan is important to employees for purposes of taxation of the benefits under the favorable rules provided under Section 402 and Section 2039(c) of the Internal Revenue Code and for purposes of determining whether income earned by the trust is taxable under Section 501(a) or exempt.

The *Journal* wishes to point out that the Internal Revenue Service has expressly stated that the IRS will not consider the issue of discrimination in state and local government plans. In a recent release to the Manual Supplement of the IRS manual, the Internal Revenue Service directs key districts to not raise issues of discrimination in state and local government plans and to consider such plans qualified if they meet the other requirements of IRC §401 apart from those relating to discrimination. In addition, the directive indicates that the question of the taxability of such trusts should also not be raised. See the *Compensation Journal*, Tax Management Inc., Washington, D.C., May 1978, p. 42.

[16] U.S. Department of Treasury, News Release, Internal Revenue Service, IR-1798, April 21, 1977.

[17] Lee Stern, "Public Pension Plans Feel Heat From IRS." *Pensions and Investments*, June 6, 1977.

[18] *Ibid.* Municipal Finance Officers Association, *Newsletter*, Sept. 1, 1977, Vol. 52, No. 17; The National League of Cities, Resolution No. 5, "Exemption of Public Pension Plans from the IRS Reporting Requirements," Annual Business Meeting, San Francisco, Calif. December 7, 1977; and Mitchell C. Lynch, "Confrontation Nearing Over Tax Status of Local, State Employee Pension Funds." *The Wall Street Journal*, August 25, 1977.

[19] U.S. Department of Treasury, Internal Revenue Service, IR-1875, August 18, 1977.

[20] These objections resulted in the introduction of proposed legislation, S. 1587 and H.R. 9118, 95th Congress, 1st Session, 1977. See statement of Hon. Jack Cunningham, before Subcommittee on Private Pension Plans and Employee Fringe Benefits, Committee on Finance, United States Senate, March 15, 1978. See Fed. Reg. 29891, July 7, 1978.

[21] See correspondence, Jerry Wurf, president, American Federation of State, County and Municipal Employees, AFL-CIO, to Jerome Kurtz, Commissioner, Internal Revenue Service, September 9, 1977; and Statement of William B. Welsh, Executive Director for Governmental Affairs, American Federation of State, County and Municipal Employees, AFL-CIO, before the Subcommittee on Private Pension Plans and Employee Fringe Benefits, Committee on Finance, United States Senate, March 15, 1978.

[22] See Appendix.

however, *does* apply to state and local plans.

1. *The ERISA Exemptions*

The House and Senate Joint Conference Committee explanation of ERISA contains a clear statement that Title I was not intended to apply to "governmental plans." The exclusions from Title II, by the section-by-section approach, are explained, for example, as follows:

> The participation requirements of Title II apply only to plans which qualify for certain tax deferral privileges by meeting the standards as to participation and other matters set forth in the Internal Revenue Laws. However, governmental plans and church plans which do not elect to come under the new provisions will nevertheless be treated as qualified for the purposes of the tax deferral privileges for the employees, *if they meet the requirements of the present law.* [Emphasis supplied][23]

This legislative history and close review of specific sections indicates the continued validity under ERISA of the IRS's determination to apply its tax qualification regulations under 401 (a) to public plans.[24]

2. *ERISA Definitions*

The wording of the ERISA definitions of "governmental plan" confuses the issue.

Title I of ERISA sets forth minimum standards pertaining to reporting and disclosure, plan participation, vesting, funding, and fiduciary responsibility, which private sector plans must meet. Section 4(1) of Title I specifically exempts from coverage "governmental plans." Section 3(32) of Title I defines "governmental plans" as all plans which are "established *or* maintained for its employees by the government of the United States, by the government of any state or political jurisdiction thereof, or by any agency or instrumentality of any of the foregoing."

Title II, which incorporates the standards set forth in Title I as amendments to the Internal Revenue Code, also exempts "governmental plans" from coverage under many of its sections. "Governmental plans" under Title II, Section 1015, are defined, however, as plans which are "established *and* maintained for its employees by . . . any state or political jurisdiction thereof. . . ." Title IV of the act, which establishes a system of plan termination insurance, exempts governmental plans. But, it too uses the same "*and*" definition employed in Title II of the act.

Ands, Ors, and Coincidences

These definitions raise the obvious question as to whether the substitution of the conjunction "and" for the conjunction "or" was intentional or accidental. Regulations under Title I are the drafting responsibility of the Department of Labor, and those under Title II must be drafted by the IRS. However, nearly four years after ERISA's enactment, regulatory definition of "governmental plans" has not as yet been issued by either department. This creates doubt as to whether some plans long thought of as public plans may in fact be covered by ERISA.

3. *The Regulatory Delay*

In September 1976 Dallas L. Salisbury, then Acting Director of the Office of Policy Planning and Research under the Labor Department's Administrator of Pension and Welfare Benefit Programs, reported that the Department of Labor had received few comments suggesting how a public plan should be defined. Salisbury also pointed out that the Department had indicated in opinion letters that it believes that a plan must be clearly "established *and* maintained" by a public employer to qualify for exemption. The Bureau of National Affairs reported that:

> As an example, he [Salisbury] said that if a plan has an odd number of trustees, the majority of whom represent the public employer so that the employer has authority over the plan, the Department would consider the plan to be a public plan. He noted that the Department's legal counsel is inclined at this point to interpret ERISA's requirements conservatively, so that, for example, if a board is composed of an even number of trustees, exactly half of whom represented the employer, the government unit would have to have final authority in the case of a deadlock so that it maintained control of the plan.
>
> This strict interpretation could mean many plans would be subject to ERISA, he said, adding that the Labor Department is looking for input to aid in its development of a definition of public plan.[25]

In January 1977, Salisbury reported that an "early spring issuance is currently scheduled."[26]

By the fall of 1977, the Department of Labor had issued eight opinion letters (but no regulations) on the ERISA definition of "governmental plan." Each letter took the position that a plan must be both established *and* maintained by a government; "maintained" meaning "financed *and* controlled." These letters take a very conservative approach.[27]

To date, neither IRS nor the Department of Labor had defined "governmental plan" further.

On March 31, 1978, the Legislation and Regulation Division of the IRS Office of Chief Counsel issued a report on the status of regulations projects. The definition of governmental plans was assigned the lowest priority.[18]

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[23] ERISA Conference Report, as reprinted CCH, *Pension Reform Act of 1974*, (Chicago: Commerce Clearing House, 1974), para. 5015; see also discussion above on IRS.

[24] See section above on IRS; and Rev. Rul. 72-14 (1972).

[25] *BNA Pension Reporter*, No. 10 September 20, 1976, p. A-3F.

[26] Conversation with Leibig and Kalman, January 24, 1977.

[27] See Dallas L. Salisbury, "Public Employee Benefit Plan Reform," EMPLOYEE BENEFITS JOURNAL, fall 1977, p. 8f; and Russell Mueller, "Federal Regulation of Public Pensions: The Turning Point," *1976 Retirement Proceedings*, (Chicago: Municipal Finance Officers Association, 1976), p. 2.

B. *CETA and Pensions*

The Department of Labor operates a public jobs program under the Comprehensive Employment and Training Act (CETA—Public Law 93-203). In 1977, the Department issued regulations concerning CETA employee participation in public pension plans. The regulations provided basically that when CETA money is used to pay pension contributions for CETA employees, and when those employees are later discharged without a vested pension right, CETA pension contributions must be placed in an escrow or reserve account, or some other arrangement must be made so that the moneys are returned to the federal government. A waiver period to comply with the regulation was allowed.[19]

These retirement regulations were based on the assumption that CETA employees are temporary employees. The regulation, therefore, sought to discourage participation in a pension system but, in fact, created a series of very specific and difficult problems for public pension systems.

Participation Often Required

Many public retirement statutes, sometimes even state constitutions, require that all employees, including CETA employees, be participants in a specific pension plan. Many of these laws also mandate that employer pension contributions on behalf of participants may not be withdrawn. A further problem results when, as is often the case, a plan is funded actuarially with no possibility that specific contributions are allocated among employees.

After the regulations were issued, a preliminary survey of state CETA retirement problems found that:

- CETA participants in some public pension plans could not be dropped from the system.
- Very few systems had sufficient funds to provide pension contributions for CETA employees without federal assistance.
- Some jurisdictions tied health and disability insurance to pension plan participation. Consequently, separation of benefits for CETA employees was impossible.
- Many state retirement laws would not allow a reserve account to be established.
- The waiver system did not work well.
- Only one jurisdiction of 46 surveyed could comply with CETA rules by legislative amendments to the public pension plan.

The CETA pension regulations demonstrated a lack of basic understanding of public pension planning and actuarial principles. The regulations had been issued without consultation of any kind with pension experts, either within the Department of Labor or elsewhere.[30]

IV. *OTHER AREAS OF FEDERAL ACTION*

A. *Federal Anti-Fraud Protection: Daniel v. Teamsters*

In August 1977, the United States Court of Appeals for the Seventh Circuit held that a private plan participant's interest in a mandatory, noncontributory pension plan is protected by the anti-fraud provisions of federal securities law.[31]

John Daniel had participated in a Teamsters' pension plan for 22 years. When he retired, Daniel was informed that he was ineligible for the $400 a month he had expected. A four month layoff, which occurred 13 years earlier, constituted a disqualifying break in service. Daniel sued, charging fraud under federal securities laws.[32]

Under the anti-fraud provisions of federal security laws, full disclosure of all pertinent facts about investments is required. Daniel's application of this principle to pension law was novel, but successful. The case is now before the U.S. Supreme Court.[33]

Daniel's theory, if upheld, could affect pension participants' rights more crucially than any other event since the enactment of ERISA.

Whether the *Daniel* theory would apply to public employee participants' rights in a state or local government plan is arguable. If public employees have property or contract rights in, or equitable ownership of, a fund (where the trust fund is found to be a separate entity from the exempt public employer), a *Daniel* based anti-fraud federal security law argument for full disclosure may be successful.[34]

B. *A Federal Fiduciary Duty Rule: Landrum-Griffin Section 501(a) and the "Labor Organization" Test*

Section 501 of the Landrum-Griffin Act imposes a federally enforced fiduciary responsibility on officers, agents, and representatives of labor organizatons covered by the act. These duties apply to persons whose actions relate to employee benefit trusts. A public employee union representative is subject to Landrum-Griffin fiduciary responsibility if his labor organization is subject to the act.[35]

A "labor organization" is covered by the act if it represents, is certified

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[18] See *BNA Pension Reporter*, No. 184, April 17, 1978, p. R-5.

[19] *Federal Code of Regulations*, Title 29, Section 98.25 (October 1, 1977).

[30] Results of National Association of Counties CETA retirement survey, available in Leibig/Kalman file.

[31] *Daniel v. Teamsters*, U.S. Court of Appeals, Seventh Circuit, No. 76-1855, August 20, 1977.

[32] See Martin E. Segal Company, *Newsletter*, Autumn 1977, pp. 5-6.

[33] "Supreme Court Grants Review of Daniel Decision," *BNA Pension Reporter*, No. 177, February 27, 1978.

[34] See Note, "Public Employee Pensions in Times of Fiscal Distress," 90 *Harv. L. Rev.* 992 (1977).

[35] Landrum-Griffin Act, 29 *U.S.C.A.*, 501.

APPENDIX

A SECTION-BY-SECTION ANALYSIS OF ERISA's APPLICATION TO PUBLIC PENSION PLANS

[Section applicability to government plans are italicized]

ERISA Section	*IRC Section*	*Description*
1011		Minimum Participation Standards
1012 (a)		Minimum Vesting Standards
1012 (b)		*Comparability of Plans*
1012 (c)		Variations From Certain Vesting and Accrued Benefits Requirements
1013 (a)		Minimum Funding Standards—General
1013 (b)		Excise Tax on Failure to Meet Minimum Funding Standards
1013 (c)		Amendments to Section 404
1013 (d)		Alternative Amortization Method for Certain Multiemployer Plans
1014		Collectively Bargained Plans, Etc.
1014	413 (b) (1)	Participation
1014	*413 (b) (2)*	*Discrimination, Etc.*
1014	*413 (b) (3)*	*Exclusive Benefit*
1014	413 (b) (4)	Vesting
1014	413 (b) (5)	Funding
1014	413 (b) (6)	Liability for Funding Tax
1014	413 (b) (7)	Deduction Limitations
1014	*413 (b) (8)*	*Employees of Labor Unions*
1014	413 (c) (1) through 413 (c) (6)	
1015		
1015	414 (h) (1)	
1016		
1017		
1021		Additional Plan Requirements
1022 (a)		*Requirement That Plan Not Be Discriminatory*
1022 (b)		Amendments Relating to Self-Employed Individuals and Owner-Employees
1022 (c)		Persons Other Than Banks May Be Trustees or Trusts Benefiting Owner-Employees
1022 (d)		Certain Custodial Accounts
1022 (e)		Custodial Accounts for Regulated Investment Company Stock
1022 (f)		Insured Credit Unions
1022 (g)		*Public Inspection of Certain Information With Respect to Pension, Profit-Sharing and Stock Bonus Plans*
1022 (h)		*Publicity of Returns*
1022 (i)		Certain Puerto Rico Pension Plans
1022 (j)		Year of Deduction, Etc.
1022 (k)		Receipts for Employees
1023		*Retroactive Changes in Plan*
1031		Annual Registration and Information Returns
1032		Duties of Sec. HEW
1033		Reports by Actuaries
1041		*Tax Court Procedure*
2001		Contributions on Behalf of Self-Employed Individuals and Shareholder-Employees
2002		*Deduction for Retirement Savings*
2022 (a) (1)	*219 (a)*	*Deduction Allowed*
2002 (a) (1)	219 (b)	Limitations and Restrictions
2002 (a) (1)	*219 (c)*	*Definitions and Special Rules*
2002 (a) (2)	*62*	*Deduction Allowed in Arriving at Adjusted Gross Income*
2002 (b)	*403 (a)*	*Individual Retirement Accounts*
2002 (b)	*403 (b)*	*Individual Retirement Annuity*
2002 (b)	*403 (c)*	*Accounts Established by Employers and Certain Associations of Employees*
2002 (b)	*408 (d)*	*Tax Treatment of Distributions*
2002 (b)	*408 (e)*	*Tax Treatment of Accounts and Annuities*
2002 (b)	*408 (f)*	*Additional Tax in Certain Amounts Included in Gross Income Before Age 59½*
2002 (b)	*408 (g)*	*Community Property Laws*
2002 (b)	*408 (h)*	*Custodial Accounts*
2002 (b)	*408 (i)*	*Reports*
2002 (b)	*408 (j)*	*Cross References*
2002 (c)		*Retirement Bonds*
2002 (d)		*Excise Tax on Excess Contributions*
2002 (e)		*Excise Tax on Excessive Accumulations*
2002 (f)		*Penalty for Failure to Provide Reports on Individual Retirement Accounts*
2002 (g)		*Conforming Amendments*
2002 (h)		*Clerical Amendments*
2002 (i)		*Effective Dates*
2003		*Prohibited Transactions*
2004	*415*	*Limitations on Benefits and Contributions Under Qualified Plans*
2004	*415 (a)*	*General Rule*
2004	*415 (b)*	*Limitation for Defined Benefit Plans*
2004	*415 (c)*	*Limit for Defined Contribution Plans*
2004	*415 (d)*	*Cost-of-Living Adjustments*
2004	*415 (e)*	*Limitation in Case of Defined Benefit Plan and Defined Contribution Plan for Same Employee*
2004	*415 (f)*	*Combining of Plans*
2004	*415 (g)*	*Aggregation of Plans*
2004	*415 (h)*	*50% Control*
2004	*(Other Provisions)*	
2005	*402 (e)*	*Tax on Lump Sum Distributions*
2006		*Salary Reduction Regulations*
2007		Rules for Certain Negotiated Plans
2008		Certain Armed Forces Survivor Annuities
3001 (a)		
3001 (a)		
3001 (b)		
3001 (c)		
3001 (d)		
3001 (e)		
3002		Procedures With Respect to Continued Compliance With Requirements Relating to Participation, Vesting and Funding Standards
3003		*Procedures in Connection With Prohibited Transactions*
3004		Coordination Between the Department of the Treasury and the Department of Labor
3021		
3022		
3031 (a)		
3031 (b)		
3032 (a)		
3032 (b)		
3032 (c)		
3032 (d)		

to represent, is chartered to represent, or charters others to represent any private employees. Some public employee unions are covered by the requirements of the act.[38]

The Landrum-Griffin fiduciary rules may be available in certain si

(For text and footnote, see page 28)

STATEMENT OF JOHN J. SWEENEY, PRESIDENT, SERVICE EMPLOYEES INTERNATIONAL UNION, AFL-CIO, ACCOMPANIED BY STEVE PRUITT, LEGISLATIVE DIRECTOR

Mr. SWEENEY. Mr. Chairman, my name is John J. Sweeney, and I serve as the president of the Service Employees International Union and executive vice-president of the Public Employee Department, AFL-CIO, which is composed of 32 national unions representing in excess of 2 million workers at every level of American Government.

With me is Steve Pruitt, legislative director of the AFL-CIO public employee department.

I am pleased to have this opportunity to appear before your subcommittees today to provide you with our department and SEIU's views on public employee pension benefits plans and the need for additional Federal governmental oversight in this area.

Mr. Chairman, we would first like to commend you for your willingness to hold this joint hearing to review the need for greater Federal protection of State and local Government employee pension plans.

We welcome your concern and the real leadership you can provide toward protecting and guaranteeing the retirement benefits of public employees working for State and local Government employers.

It is our hope that we will soon see meaningful legislation and that such legislation can be enacted into law during the next session of Congress. We believe that it is long overdue and promise not to rest until we achieve this goal.

Mr. Chairman, PED and SEIU believe that the regulation, administration, and financial security of public pension funds should be a national concern. Today there are over 6,000 separately administered State and local government retirement plans, with total membership exceeding 11 million workers and retirees.

The assets of these funds are currently valued in excess of $200 billion and are expected to increase to $1 trillion within the next 15 years. The administration and the investment of that much money will necessarily exert a major influence on the structure and performance of the U.S. economy.

For this reason, Federal action is required and justified to resolve the serious deficiencies which are prevalent among Government pensions as they exist today.

Mr. Chairman, public workers have a fundamental right to know about their retirement systems, but are often kept in the dark.

In a 1981 report, the Urban Institute found reporting and disclosure from most State and local government plans to be inadequate. As many as 40 percent of State and local governments do not automatically furnish their plan participants with plan descriptions.

Eighteen percent do not even provide this information on request. Although many government jurisdictions do have some reporting and disclosure laws, the regulations are sporadic and noncomprehensive.

What information is supplied by these government plans, is either too brief or too detailed to be of any practical use to the average plan participant or beneficiary. Every day more of our members are faced with the painful reality that the job security which was once found in public service is being threatened by economic and fiscal distress and antigovernment attitudes.

Our workers will be relying more and more on what they have been setting aside for retirement as a last chance to achieve income security. Effective public disclosure about how public pension assets are being managed, is the most important first step toward protecting the Federal interest.

Prof. Roy Schotland of the Georgetown Law School has provided a good summary of the importance of Federal reporting and disclosure standards:

One. Effective disclosure activates local political processes, so that pension problems are more likely to be worked out at home.

Two. Disclosure cannot be effective unless local taxpayers and pension participants can compare how their funds are doing, relative to other similar funds.

Three. Only the Federal Government can assure comparability of information about pension plans.

Four. Required disclosure is the least intrusive and least costly form of regulation. This makes it especially appropriate when, as here, the Federal Government must take some steps affecting State and local governments in order to protect the Federal taxpayer's vulnerability as pension insurer of last resort.

Public disclosure is necessary to curb the potential for administrative abuse, abuse which victimizes plan participants and the taxpaying public. A widely cited study of the asset-management practices of State and local pension funds has documented the extent to which conflicts of interest exist in public employee pension plans.

Unfortunately, large segments of the assets held by pension funds are managed in the interest of those who control the funds rather than in the interest of those for whom the funds are intended to provide benefits.

Mr. Chairman, the PED and SEIU also believe that a secondary thrust of any legislative action in the public employee pension protection effort should include measures which effectively control the fiduciary responsibilities of plan administrators.

The lack of proper oversight in the fiduciary area can result in investment practices which yield poor returns or which support ventures operating contrary to the beneficiaries' best interest.

During the period from 1971 to 1980, the median annual rate of return on total public retirement funds was 5.8 percent; and 1981 the annual median return was only 3.3 percent. These figures are according to A. G. Becker, Inc., a leader of fund-investment performance measures.

We are not suggesting that the return rate is a direct indication of the lack of proper fiduciary management, but such a low rate of return during a 10-year period of substantially high inflation would make one question the investing practices.

Fiduciaries should not only be prohibited from using plan funds for their own personal interest and gain, but they should also be prohibited from involvement in sales, lending, or servicing transactions that would be inconsistent with proposed requirements that fiduciaries act in a prudent manner.

We cannot allow our members' retirement funds to be used in any way that would not benefit them to the fullest.

However, we would strongly suggest that so-called social investments, in the real world, and indeed prudent uses of pension funds and would, therefore, recommend that any legislative proposals in this area be flexible enough to allow, or even encourage, ventures like recent discount mortgage loan programs like those in California and Maryland which help to directly stimulate the housing and construction industries.

Mr. Chairman, the opponents of legislation to protect the pensions of public workers will argue that the Federal Government has no legal right to protect or regulate public sector pension plans, that the Federal Government would be legislating new costs to State and local governments and that State and local governments have made major strides toward improving and reforming their public employee pension plans.

Opponents' longstanding argument about separation of constitutional power, that is, States rights, has been based on the *National League of Cities* v. *Usery* decision of the U.S. Supreme Court.

Three recent actions, we believe, more adequately address this argument: The *EEOC* v. *The State of Wyoming* Supreme Court decision, Congressional passage of the Social Security Amendments of 1983 and the Tax Equity and Fiscal Responsibility Act of 1982 [TEFRA].

In each of these actions, the Federal Government's authority to impact on State and local government's retirement policies and their pension plans has undergone significant strengthening.

Opponents, while contending massive costs associated with reporting and disclosure, have yet to fully outline and justify these statements.

We believe, given existing practices of many of the State and local plans, the costs of complying with the minimal requirements as outlined in previous legislative proposals would be minor compared to what the costs would have been had public plans been fully integrated into the ERISA program.

Furthermore, we would wonder whether the costs of reporting and disclosure are greater than participants' and the public's right to know?

Finally, opponents will argue that State and local governments have made major strides toward improving their employee pension plans. We would suggest that most of the improvement, if any, has occurred on the benefits side of the equation and not necessarily on the plan administration side.

The 1978 House pension task force found:

One. Approximately one-quarter of the State plans and 40 percent of local plans do not have actuarial valuations performed on a regular basis.

Two. Forty percent of the State and local plans do not regularly furnish materials describing plan provisions.

Three. That over 60 percent of the largest State and local plans do not compute the market value of plan assets.

While the pension task force cited numerous other shortcomings in State and local plans, they summarized their findings with an extremely grave finding stating:

> [Many systems] are not operated in accordance with the generally accepted financial and accounting procedures applicable to private pension plans and other important financial enterprises.

In closing, Mr. Chairman, it is our sincere hope that coming out of this hearing we will see legislation introduced and enacted which will provide for State and local government employees similar pension protections as those extended to their private sector colleagues.

We believe that Federal reporting, disclosure and fiduciary standards are needed, justified and constitutional.

We further believe that Internal Revenue Code sections 401(a) and 501(a) have proven to be only a fading light of reform for State and local pension plans because of the total lack of enforcement by IRS and the Treasury Department.

If all the laws of this country were enforced the way sections 501(a) and 401(a) have been used in the State and local pension area, one would have to wonder if we would be here today?

We are committed to seeing legislation enacted which protects the pensions of public workers. The AFL-CIO has spoken on this issue in their resolution acted upon at its recent general convention, which is attached to my statement. The entire labor family supports us in this effort.

We look forward to working with you toward this worthy goal.

Thank you.

[An attachment to the prepared statement follows:]

PUBLIC PENSION PLAN REFORM

Whereas, Study after study of state and local government pension plans has pointed to a growing number of abuses and deficiencies in the operation of such plans. These plans which number more than 6,000 have combined assets conservatively valued at over $115 billion and have accumulated over $300 billion in unfunded liabilities.

Whereas, State and local pension plans face problems which threaten not only their own fiscal stability and the rights of plan participants and beneficiaries but also the fiscal integrity of state and local governments as well. The benefit design of many of these plans is ill-conceived, and many are dangerously underfunded. No comprehensive and uniform set of legal principles exist to adequately regulate state and local government plans. Conflict of interest problems are pervasive, and the absence of meaningful reporting and disclosure and fiduciary standards is the order of the day. Far too few of those directly affected by public pension decisions are involved in the decision-making process. A coherent federal regulatory policy which recognizes the unique problems and characteristics of state and local plans has yet to be established; therefore, be it

Resolved: That the AFL-CIO re-emphasize its view that current regulation of state and local plans is inadequate and that federal legislation must be enacted to provide public employees with long-needed protections against the abuses and deficiencies existing in public pension plans; and, be it further

Resolved: That the AFL-CIO urge Congress to move without delay in enacting federal legislation prescribing minimum reporting, disclosure and fiduciary standards for state and local government pension plans.

Mr. CLAY. Thank you.

Ms. Linda Tarr-Whelan.

STATEMENT OF LINDA TARR-WHELAN, DIRECTOR, GOVERNMENT RELATIONS, NATIONAL EDUCATION ASSOCIATION

Ms. TARR-WHELAN. Good morning, Mr. Chairman.

Mr. CLAY. Your statement has been included in the record. We would appreciate it if you would summarize.

Ms. TARR-WHELAN. I will summarize it very quickly.

My name is Linda Tarr-Whelan, director of government relations with the National Education Association.

We certainly appreciate the opportunity to testify before you in this joint hearing this morning on such a distinguished panel with whom we agree on this issue.

NEA's position on public employee retirement accountability really has three basic interlocking premises.

First, retirement plans should be seen as deferred payment for services rendered, a condition of employment.

Second, public employee retirement systems are created and are to be operated for the purpose of providing retirement benefits to their members.

Third, public employees are entitled to no less protection of their retirement income than their counterparts in the private sector.

My statement, Mr. Clay, provides detailed information about the need, but I believe you have heard substantial testimony with regard to that this morning. Let me summarize some of the basic elements that we think are important in this type of legislation.

First of all, we have been working on this issue for many years, have done a lot of investigation with our members, and have conducted a survey, which we do every 5 years.

Our experience indicates that there is a need for standardized term reporting periods and some guarantee that the numbers which are reported are comparable. Only then will members of public employee retirement systems and the taxpayers know how well their State systems are doing when compared to other States.

Second, we believe that plan participants must have adequate access to pertinent information about their plan, its operation, and its benefits.

Third, we believe that at a time of significant financial distress at the State government level we should be and you should be deeply concerned about the need to protect the health and solvency of our members' pension funds.

In past times the assets of pension funds have been managed by political leaders in a way which may have helped solve State budget problems, but jeopardized investments on behalf of employees. Even the most minimum fiduciary responsibilities have appeared lacking on occasion.

Next, we believe State and local retirement systems and programs should include actuarial and investment policies that produce sound financing, annual independent review and audit, protection against incursions on retirement system assets by State and municipal governments, and fiduciary standards that mandate the prudent operation of public employee pensions.

We believe that the desire of public employees to have a property right in their retirement system is not in fact a whim. Yet our survey of 40 States shows retirement benefits in eight States considered only a gratuity benefit, in only 24 are guaranteed by State statutes, and only eight States have a constitutional guarantee of benefits.

We find pension portabilities a concern. Almost a quarter of a million of our members left teaching in their States and were unable to carry the pension with them.

We also would strongly urge that minimum standards include vesting at no longer than 5 years and that portability options be explored by this committee.

We believe that the Federal Government has an interest and responsibility in the protection of public employee pension funds. Many States and municipalities, as you well know, rely heavily on Federal funds to help meet their pension cost.

In addition, the Federal Government can and should play a role in assuring that public pension plans are operated openly and honestly. It can do so without intruding on the autonomy of State and local governments.

We supported very strongly PEPPRA legislation which came out of this subcommittee last year. We felt that it had the basic elements of legislation which we find very helpful.

We find it most interesting that this modest proposal still generates the same kind of overblown resistance by many organizations that makes one believe that perhaps they have not carefully read this piece of legislation as it came out of the committee the last time around, particularly with regard to the opting out provisions for States that meet the minimum requirement.

I have attached to my testimony the NEA policy with regard to this issue.

We stand ready to work with both committees in enactment of this legislation.

Thank you.

[The statement of Ms. Tarr-Whelan follows:]

STATEMENT OF LINDA TARR-WHELAN, DIRECTOR OF GOVERNMENT RELATIONS, NATIONAL EDUCATION ASSOCIATION

Mr. Chairmen, I am Linda Tarr-Whelan, Director of Government Relations for the National Education Association—our nation's largest organization of teachers and others in the field of education. We deeply appreciate the opportunity to appear before this joint hearing this morning and to present our views on a subject of deep and pressing concern to our 1.7 million members and their families: the scope, conduct, and financial status of public employee pension benefit plans.

NEA's position on these matters begins with three simple, interlocking premises. First, retirement plans should be seen as deferred payment for services rendered—a condition of employment—no more, no less. Second, public employee retirement systems are created and are to be operated for the purpose of providing retirement benefits to their members. And third, public employees are entitled to no less protection of their retirement income than their counterparts in the private sector.

Those who work in public education want what every other American worker wants—a sound, predictable, and enjoyable retirement. They, like all Americans, have every right to expect that their retirement systems be secure and adequately funded, that their public pension plans be operated openly and honestly, that benefits promised will be benefits paid. They want and deserve reasonable ownership rights to their plans and the opportunity for options that would make their pension plans portable. They are entitled to certain basic information about their plan's condition and activities and about their own benefits and rights—and they should have that information presented to them in a manner that is clear, understandable, and uniform.

If all of these conditions were satisfied, there would be little need for us to be here today. But, sadly, such protections and assurances are all too often lacking. In state after state, public employees find their pension plans not funded on a sound actuarial basis. Far too many public employees are unable to obtain adequate or accurate information about their own pension programs. Far too many times have they learned of the imprudent management of public pension funds.

These are not "technical" matters, as some suggest. They are serious infringements on the basic rights of public employees. And they are of deep concern to the NEA.

A HISTORY OF INVOLVEMENT

Our concern and involvement in these issues have been longstanding. As early as 1936, at a time when only 21 states has statewide retirement systems for teachers, NEA helped found the National Council on Teacher Retirement through a merger of its own Committee on Retirement Allowances with the National Council of Teacher Retirement Systems. In the years that followed, NEA helped facilitate the establishment of statewide teacher retirement systems through the paublication of guidelines and procedures. Moreover, from 1946 to 1951, NEA and NCTR maintained a joint committee known as the Pension Reciprocity Committee. This panel conducted its work with the full support of retirement system administrators and the NEA. Its goal was to establish a mechanism for the transfer of pension credits across state lines. Unfortuately, this project ended in failure—a failure somewhat tempered, however, by the committee's success in reducing vesting requirements and making deferred allowances part of retirement system provisions.

STANDARDIZED TERMINOLOGY, REPORTING, AND DISCLOSURE

The NEA has, since the end of World War II, published summaries of retirement provisions for teachers and other school employees. In 1977, this endeavor was computerized and a special questionnaire was carefully designed to facilitate data entry. Each biennium since then this questionnaire has been improved and made more precise. With greater precision in the questions, however, we have found greater gaps in the responses.

For example, we have found that average benefits paid as reported by the retirement systems simply cannot be compared with each other. Not every retirement system, for instance, has the same fiscal year. Nor did every retirement system even report the same year. Our experience clearly indicates that there is a need for standardized terms, reporting periods, and some guarantee that the numbers reported are comparable. Only then will the members of public employee retirement systems and taxpayers know how well their state systems are doing when compared to those of other states.

But uniform terminology and comparability between plans is only a beginning. Plan participants must have adequate access to pertinent information about their plan, its operations and benefits. We believe that those who work in education, indeed all public employees, have a fundamental right to know about their own retirement systems. Yet as a 1981 Urban Institute study noted, reporting and disclosure from most state and local plans appear to be inadequate. According to the report, at that time as much as 40 percent of public employee retirement programs did not furnish plan participants with plan descriptions as a matter of course. In fact, almost 20 percent did not even provide this basic information on request. Furthermore, that information which was provided was often too complex or too vague to be of any practical value to the average plan participant.

THE NEED FOR PRUDENT STANDARDS

At a time of significant financial distress at the state government level we remain deeply concerned about the need to protect the health and solvency of our members' pension funds. In times past the assets of pension funds have been managed by political leaders in a way which may have helped solve state budget problems but jeopardized investments on behalf of retirees. Even the most minimum fiduciary responsibilities appeared lacking on occasion.

For over a decade, various actions have been taken by state governments to reduce the state contribution to their retirement funds, exacerbating the financial difficulties of the retirement systems and transferring a pension obligation of this generation to the next generation.

For instance, in 1971, the California legislature appropriated $97 million to the State Teacher Retirement System. Governor Ronald Reagan, in order to balance the budget, reduced the appropriation to $20 million, putting in jeopardy retirement checks of 43,000 retired teachers and forcing the STRS board to make up the difference from its contingency fund which at that time was largely composed of teacher contributions.

Various other problems of prudent management have arisen. In some instances, money has either been withheld from the pension fund or payments delayed, causing a loss of investment income for the system. At times, governors and/or legislature have refused to fund the retirement systems at the level recommended by the actuary.

In the 1973–75 recession, and whenever finances are squeezed, state administrations experience extreme pressure from business, real estate, and mortgage banking interests to make pension assets available for bond purchases to aid local development, or to provide financial assistance to troubled cities. NEA is concerned that such investments may be made at a lower yield than could be obtained on the open market or would not meet a prudent person standard. Earnings on investment represent approximately 44 percent of the income of the major public employee retirement systems; therefore, the earmarking of pension funds for goals other than the protection of assets and earning of the greatest yield, is of genuine concern.

We believe that state and local retirement systems and programs should include actuarial and investment policies that produce sound financing, annual independent review and audit, protection against incursions on retirement system assets by state and municipal governments, and fiduciary standards that mandate the prudent operation of public employee pension plans. Such procedures are essential to safeguard the interest of the public and the future of potential retirees.

OWNERSHIP OF BENEFITS

The desire by public employees to have a property right in their retirement systems is not a whim. The Pension Task Force Report cited examples where state courts have denied complaints by public employees against retirement systems because these plans were considered a "mere gratuity." Our survey of 40 states shows that retirement benefits in eight states are considered a gratuity. Benefits in 24 are guaranteed by state statutes and only eight states have a constitutional guarantee of benefits (Alaska, Hawaii, Illinois, Maryland, Michigan, New York, North Carolina, and Washington).

NEA is concerned that teachers who have worked in the classroom receive retirement benefits which are clearly part of earned wages. Public school teachers are members of either a state or a city retirement system as a condition of employment from their first day in the classroom. In all but three of these systems (covering 95 percent of participants) a percentage of each paycheck, as much as eight percent, is deducted as a member contribution to the retirement system.

In addition a portion of their wages is paid to the retirement system either by the state or by the school board to provide a retirement income when teachers reach retirement age. According to the Bureau of the Census report, as of September 30, 1982, income to major public employee retirement systems come from the following sources:

	Percent
Employer contribution	39.2
Earnings on investment	44.3
Employee contribution	16.5

Last year, an estimated 225,000 teachers withdrew their contributions from their pension funds because they had left teaching employment in their state. They could not withdraw their portion of the earnings on investment and the corresponding employee contribution. Indeed, in the 33 states from which we have recent data, the retirement system benefited by over $700 million in unrefunded employer contributions.

The problems of pension portability due to crossing state lines has been a long term concern of the NEA. In 1946, after the last state established a teacher retirement system, NEA and the National Council on Teacher Retirement again turned their attention to developing a system of reciprocity of pension credits between states. This 15-year effort resulted in the enactment in many states of provisions which permit deferred retirement allowances and the purchase of out-of-state credit, but barriers to reciprocity of pension credits remain. Two of these barriers have been alluded to—the lack of standardization of pension terminology, and generally accepted minimum standards.

The length of time for vesting in many states remains a problem. The average requirement of the plans NEA surveyed in 1980 is nine years service regardless of age and eight years service at an average age of 56. Teacher plans have made some progress because 23 plans vest in five years or less.

NEA strongly urges that the minimum standards include vesting at no longer than five years and that portability options be explored.

A FEDERAL APPROACH

Today, there may be as many as 6,600 state and local government pension plans, representing a major source of future retirement income for more than 11 million public employees and their dependents. Yet unlike employees in the private sector, there individuals have virtually no federal protection for their pensions. Perhaps this would be of little concern if state law always provided the kind of protection these men and women need and deserve. Sadly, a wide range of studies has demonstrated the continuing inadequacy of many state statutes.

Clearly, the federal government has an interest and a responsibility in the protection of public employee pension funds. Many states and municipalities rely heavily on federal funds to help meet pension costs. The growth and maintainance of such plans has had and continues to have an everincreasing effect on federal revenues. This growth, moreover, has been substantially facilitated by the favorable tax treatment of participants and beneficiaries, investment earnings and contributions. As a result, we believe that the federal government can and should play a role in assuring that public pension plans are operated openly and honestly and that it can do so without intruding on the autonomy of state and local governments.

It is this concept which was at the heart of the Public Employee Pension Plan Reporting and Accountability Act, which was reported from the House Committee on Education and Labor as H.R. 4928 and H.R. 4929 in the 97th Congress. What this legislation would have done is rather straightforward. It would have established federal reporting, disclosure, and fiduciary requirements for public employee pension plans. And it would have done so while maintaining, indeed encouraging, state regulation of such plans. In fact, this legislation provided an exemption from federal regulation in the area of reporting and disclosure where state laws set substantially equivalent standards.

What PEPPRA would not have done is equally clear. It would not have mandated federal control or a federal takeover of state and local pension plans; it would not have affected any state law or plan provision relating to eligibility or benefits; it would not have overridden any existing state protections; it would not have increased the potential tax liability of any public plan participant; it would not have even directed the establishment of a state plan nor would it have directly assured that state or local plans were adequately funded.

NEA has long supported legislation which would provide a clear statement of pension definitions, minimum reporting, disclosure, and fiduciary standards, and a mechanism for states which meet minimum standards to be exempt from federal oversight. We, of course, would not favor any legislation that would adversely affect the pension rights and benefits of public employees and their families.

Our analysis indicates that PEPPRA, as it emerged from the Committee on education and Labor in the last Congress, meets the NEA policy (copy attached) and would have been of tremendous assistance to teachers and other education personnel across this nation. What was true in the 97th Congress remains true today. We continue to support such legislation and hope that these two distinguished Subcommittees will act quickly in the development, introduction, and passage of such a bill. Its enactment would enable us to move another step closer to developing a rational and effective retirement income policy and insure the economic security of our older citizens.

We appreciate your interest in this important subject and look forward to working with you in the weeks and months ahead.

Thank you.

THE NEA LEGISLATIVE PROGRAM FOR THE 98TH CONGRESS

Third Tier: NEA Continuing Legislative Concerns.

I. IMPROVING THE WELFARE, PROFESSIONAL STATUS, AND PERSONAL ECONOMIC SECURITY OF ALL ACTIVE AND RETIRED MEMBERS

G. *Teacher retirement.* Continuing support shall be given to a mobile teacher retirement assistance act. Assets and earned benefits of retirement systems shall be protected and incursions prevented. Support of federal legislation is predicated on exemption of states where statutes are substantially equivalent to the federal statute and/or regulations. Basic principles for retirement programs include fiduciary and reporting standards, standards for vesting and portability, ownership, and credit for military service as established in Resolutions adopted by the Representative Assembly.

NEA RESOLUTIONS

E. Protect the rights of educators and advance their interests and welfare.

E-10. Teacher Retirement

The National Education Association shall provide leadership in teacher retirement and believes that state and local retirement systems and programs should include—

a. Autonomous boards of trustees, the majority of which are elected by and from the membership.

b. Actuarial and investment policies that produce sound financing.

c. Annual independent review and audit.

d. Immediate and full vesting after not more than five years of service.

e. Provisions permitting the purchase of teaching credit earned while a member of another retirement system and credit for leaves for maternity/paternity, including adoption.

f. Normal retirement of at least 50 percent of the highest single year's rate of salary after 20 years of creditable service, where actuarially sound, and with destacking provisions; voluntary retirement under these provisions.

g. Disability retirement for a service-connected disability available to teachers from the first day of employment. Nonservice-connected disability retirement shall be available to teachers after five years of service.

h. Automatic cost-of-living increases to retirees and beneficiaries.

i. A joint federal-state program to provide those who have taught in two or more states, or in the Overseas Dependents School System, or other government schools, with benefits substantially the same as they would receive if they retired after a career in one state. Affiliates' support of state statutes compatible with the proposed federal Mobile Teachers Retirement Assistance Act or any program providing comparable portability coverage and Association assistance in preparing and promoting such legislation.

j. Full funding and equitable administration in the granting of teacher retirement credit for military service, or provision for purchasing up to five years of retirement credit for military service.

k. Nondiscrimination on the basis of sex or marital status.

l. Retirement credit for unused sick leave.

m. All compensation, including extra-duty pay, in computing retirement benefits.

n. Benefits not reduced by other sources of income, including Social Security benefits.

o. Preretirement counseling.

p. Retirement housing facilities for teachers.

q. Teachers' contributions and benefits that are not subject to federal income taxation.

r. Internal Revenue Service rules and regulations which are not discriminatory.

s. Annual financial statement distributed to all members.

t. Tax-sheltered annuity and deferred compensation plans with a broad choice of programs that would be available to all members. (69, 81).

E-34. Protection of Retirement System Assets and Earned Benefits

The National Education Association believes that retirement system assets can be invested in all types of investments. Equal consideration should be given to probable income and probable safety of the capital. All retirement benefits earned by teachers should under the law be payable to such teachers. Every effort should be made to maintain or improve existing retirement benefits. No person participating in a retirement system should be forced to accept any reduction in benefits below those in force at any time during the period of membership. The retirement benefits are earned and, therefore, inviolate.

The Association is aware of incursions on retirement system assets by state and municipal governments. Such incursions involve either a misuse of assets or the failure to appropriate required funds to the system. Both practices result in increasing accrued liabilities, which reduces the financial soundness of the system and jeopardizes the security of teacher retirement benefits. The Association believes that these incursions on retirement systems can best be prevented by the passage of preventive federal and/or state legislation.

The Association also believes that a retirement system should be exempt from federal regulations when its plan is in compliance with minimal standards prescribed by federal, state, and local statutes. (76, 82).

Mr. CLAY. Thank you.

There is a vote on the floor of the House, so the subcommittees will recess for 5 minutes.

[Recess.]

Mr. CLAY. The subcommittees will come to order.

Mr. SWEENEY. Mr. Chairman, with your permission, I would like to be excused. I have a time problem for another meeting. I will give my proxy to Mr. McEntee if you wish.

Mr. CLAY. Yes. We certainly appreciate your testimony.

Mr. Schaitberger, do you have a statement?

STATEMENT OF HAROLD A. SCHAITBERGER, LEGISLATIVE DIRECTOR, INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS (IAFF)

Mr. SCHAITBERGER. We have submitted a statement to the committee for the record if it could be included in its entirety.

I will not take the time to even summarize it.

I would like to underscore a point of interest that may contrast slightly with my fellow panel members.

That is that the International Association of Fire Fighters, of which I am legislative director, did not always find themselves as proponents of this legislation.

Early on, as a matter of fact, before hearings that you chaired approximately 5 years ago, we found ourselves as opponents to this legislation. The unfortunate part is that that opposition was based on fear and lack of sufficient information and knowledge.

Your suggestion at that time was that maybe we ought to take a little better look not only at the proposal, but the retirement systems which cover and provide benefits for our members throughout the country.

We did that and we worked closely with the staff of the subcommittee and it did not take very long to find out that in fact there was a need for minimum standards, particularly in the areas of reporting and disclosure, and there was a great need for at least minimum and adequate fiduciary standards.

Since that time we have become proponents of this legislation.

I wanted to at least draw that contrast and underscore that we were not an organization that just automatically supported an issue, we had to go through a learning process and a process which changed fear into knowledge and that knowledge now allows us to be strongly in support of this legislative effort to the point that we will hold a national conference in Washington, D.C., in late January at which the issue of PEPPRA will be the priority and center focus of the conference.

With that, I would like to thank you for the opportunity to have joined the panel today.

[The statement of Mr. Schaitberger follows:]

STATEMENT OF HAROLD A. SCHAITBERGER, LEGISLATIVE DIRECTOR, INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS

Mr. Chairman, members of the Subcommittees, my name is Harold A. Schaitberger, and I am Legislative Director for the International Association of Fire Fighters (IAFF), an international union affiliated with the AFL-CIO-CLC. The IAFF represents approximately 170,000 professional fire fighters throughout the United States and Canada. With our membership being comprised of public employees working at all levels of government, who are also participants in numerous governmental pension plans, we take a particular interest in any federal initiatives dealing with public employee pension plans and their regulation.

Let me first state that the IAFF is in firm support of legislation that seeks to provide appropriate retirement income protections to our members through minimum federal reporting, disclosure and fiduciary standards for state and local public employee pension plans. Further, we believe that H.R. 4929, the Public Employee Pension Plan Reporting & Accountability Act (PEPPRA), as reported by the Education and Labor Committee in the last Congress, provides an optimum level of protections to public employee pension plan participants.

I should point out that the IAFF opposed legislation for the federal regulation of state and local pension plans introduced in past Congresses, most particularly the Public Employee Retirement Income Security Act (PERISA). When PERISA was introduced into the 97th Congress by the distinguished former Chairman of the Labor-Management Subcommittee Phillip Burton, the IAFF opposed and testified against its passage, as we had opposed all previous PERISA bills. Our understanding of what the effects of PERISA would be, led us to believe that its provisions were overly comprehensive and unnecessarily intruded into the retirement affairs of state and local public employees and their pension systems. On the other hand, the bill did contain provisions whose direction towards minimal reporting and disclosure standards we do support.

Chairman Burton found merit in many of our arguments and solicited our input in helping to refine the measures so that it would truly reflect and protect the best interests of public employee pension plan participants. The IAFF worked together with the Subcommittee and Committee staff, and these efforts resulted in a new bill sigificantly changed and re-designated PEPPRA.

The IAFF believes that this PEPPRA legislation is a prudent and carefully drafted response to the problems currently facing public pension plans and their participants. We can see that the serious problems facing state and local government plans threaten their fiscal stability and the rights of their participants and beneficiaries. They also threaten the overall fiscal integrity of state and local governments as well.

No comprehensive or uniform set of regulations and principles currently exist for the adequate regulation and administration of state and local government plans. There are exceptions, of course, and we note that there are several states, for example Ohio, Colorado and Nevada, which have independently established comprehensive reporting, disclosure and fiduciary standards. However, the majority of state and local government plans fail to meet the minimum standards proposed in PEPPRA. Conflict of interest problems exist, and there is an absence of understanding on the part of plan participants of the entitlements that are being provided by their pension programs. A federal regulatory framework whch recognizes the problems and characteristics, along with the needs of state and local plans has yet to be established.

We believe the Federal government has a responsibility for insuring the minimum reporting, disclosure and fiduciary standards are met by state and local government retirement plans. Current reporting and disclosure practices of many state and local plans are generally inadequate. In many instances plan participants are not informed of their basic benefit rights through a plan booklet; not to mention, being appraised of the financial condition of their plans.

Many of the current financial reporting procedures do not provide sufficient information to allow participants to judge the financial performance of their funds. Many plans do not disclose the current market value of their plan assets, nor do they provide information that would permit the evaluation of investment managers or portfolio managers. This lack of reporting and disclosure requirements leaves many pension plan participants and their beneficiaries without a realistic assessment of their pension benefits and entitlements, or the strengths and weaknesses of the retirement system under which they are covered.

It should be emphasized that the lack of regular systematic reporting and disclosure practices do not only pose a problem for plan participants and beneficiaries. Tax payers and investors, and even government officials, are sometimes kept in the dark regarding the true costs and investment practices of state and local government pension plans.

Another area of great concern is the lack of uniform standards of fiduciary conduct for public plan fiduciaries and trustees. State and local control over the management of plan assets frequently has been inadequate, as are the existing legal protections for public plan participants. Conflicts of interest in management and investment practices and other examples of fiduciary misconduct have occurred due to the absence of a uniform standard of conduct.

We have observed situations where plan fiduciaries have acted primarily in the interest of others, rather than of the plan participants and their beneficiaries. Many times these fiduciaries are directly connected with the governing body, and their decisions may be slanted toward favoring the interests of the state or local government itself.

Opponents to any regulation of public employee pension plans argue that the federal government should not intervene. The IAFF, however, believes that PEPPRA serves a national need and represents an appropriate response to current public plan problems through a minimal degree of federal intrusion into state and local government.

The proposal does not mandate the existence of a state or local pension plan, nor the level of benefits that must be provided through these plans. It merely seeks to provide some assurance that benefits promised under a voluntarily adopted plan are paid, and that the plans are operated without discrimination and in a prudent administrative and fiduciary manner.

It is our understanding that PEPPRA, H.R. 4929 as reported in the last Congress, is to be re-introduced in the near future. The IAFF supports this legislation, since its provisions fully reflect our policies and positions on the issue of federal regulation of state and local government pension plans, providing needed retirement income protections while at the same time avoiding needless federal government intrusions. The bill serves to protect the interests of plan participants and the plans themselves in a number of ways:

(1) PEPPRA guarantees that each pension plan participant will be provided with appropriate annual reports informing them of the status of their pension fund, including its financial condition, any unfunded liabilities, and funding mechanisms that are being used;

(2) It requires that participants be informed of their current contribution status, including any contributions or interest payments made in their behalf and any vested retirement benefits they are entitled to;

(3) The bill sets up minimum fiduciary standards to guarantee that individuals responsible for the administration and investment of pension funds would be required to meet reasonable prudent rules in carrying out their responsibilities;

(4) It prohibits employers from using pension fund monies to purchase employer securities in excess of 5 percent of pension fund assets;

(5) It allows for the exemption of any State or local plans from the Federal law in States where the Government certifies that State law contains substantially equivalent provisions.

The IAFF believes that enactment of PEPPRA is truly necessary in order to protect the vital national interests and the rights of public plan participants and their beneficiaries. We therefore respectfully request that you support this legislation when it is introduced into this Congress and during your Committees' consideration of this issue.

I thank you for your time and consideration of the comments we have made today on behalf of our members.

Mr. CLAY. Ms. Tarr-Whelan, why is this legislation such a high priority for the labor unions?

Ms. TARR-WHELAN. I am speaking from the standpoint of the National Education Association, what we have found is our member teachers' retirement system throughout the country generally are State systems which are more likely to have the kind of requirements that are listed in this legislation, but our members cannot find out basic information about their pensions.

They cannot find out the rate of investment. They cannot find out exactly how things are running and what to expect as far as retirement is concerned.

More than that, they cannot work on the issues which need to be done at the State level. If the information does not exist, it is impossible to organize and to advocate a change in the State legislature in order to improve the situation.

The last one I think is unique to teachers, but certainly a real problem and that is the mobility of teachers. I mentioned a quarter of a million teachers left their position last year and moved from one State to another. The portability of their pension rights is a very, very difficult problem.

We think at the base of that is the fact you can't compare one pension to another. The information does not exist, so our members are concerned about the issue of mobility. They see this as a bottom line approach to beginning to deal with the problem of mobility on pensions.

Mr. CLAY. Thank you.

Mr. Pruitt, last year when the Committee on Education and Labor reported out pension legislation we adopted a provision which would exempt plans from reporting requirements if the governor certified the State has substantially equivalent laws.

Do you support that position?

Mr. PRUITT. We have some reservations with that, Mr. Chairman. The primary reason is that without some standardized reporting and disclosure features in the law and some standardization across the country, we don't really know what the Governor certifies.

I think you have heard in other testimony today that because of the lack of information, I am not too sure that the governor can make an adequate decision on that if he has to certify those plans are actually equivalent to the Federal standards.

Mr. CLAY. Mr. McEntee, one of the witnesses who will testify later this afternoon represents the Teacher Retirement System of Texas. I understand that last year you wrote a letter expressing some concern to him about their lobbying tactics and opposition to PEPPRA.

Is that correct?

Mr. MCENTEE. That is correct.

Mr. CLAY. What was the basis of your concern?

Mr. MCENTEE. If you will pardon the pun, we did have a shootout with our friends from Texas. As you know, there were extensive hearings on this type of bill a little more than a year ago.

Pertaining to those hearings—I think the date was May 13, 1982—the administration of the Teachers Retirement System of the State of Texas sent out a circular to thousands of participants in the Texas system which in our judgment contained highly inaccurate information in terms of the bill that was being considered.

If I may, I would like to quote from the circular and I do quote:

> The bill overrides the existing State constitutional protections for members and annuitants, the bill provides the means to allow investment of retirement funds at lower rates for social purposes, for example, to bail out insolvent governmental units with low-cost loans. The legislation would place Federal controls on State and local government employee benefits and it would open confidential individual accounts to public disclosure.

Now, in fact, we all know and we certainly believe they knew that indeed none of this was in the bill or being considered by any committee.

We were highly upset about this because the circular generated anxiety and real concern on behalf of members and annuitants of that particular plan and that in turn generated considerable mail to the congressional delegation from Texas.

When we heard what was happening and when we saw the circular I did indeed write a letter to the executive secretary of this system bringing to that person's attention that in fact this legislation indeed did not do any of those things and that we thought that it was in fact a very irresponsible action.

We asked him if he would send out a letter of clarification clearing up the matter. That never did happen.

Maybe it is another example of why we so desperately need this kind of legislation so that indeed participants and annuitants and members of these systems all across the country, whether they be in Texas, Minnesota, or Massachusetts, indeed will have knowledge of where they stand in terms of these systems.

I think it is also important, if I may, Mr. Chairman, to underscore the fact that contrary to our sisters and brothers in the private sector, 70 percent or maybe even up, and we are not sure because we can't get a handle on it, but 70 percent and up of State and local plan participants are in contributory type systems in the public sector.

Not only do we have the employer contribution which is in fact a deferred wage contribution anyway because if it was not in the pension, it would be in the pockets of our people in terms of a wage increase, but in addition to the deferred wage aspect, 70 percent of our State and local workers are in contributory systems as compared to our counterparts in the private sector where very few of the pension systems are contributory.

So, our people have a dual kind of interest in terms of the systems and being able to check out the systems, being able to check out the investment portfolio and the policy and direction of these systems.

Mr. CLAY. Did you get a response to your letter?

Mr. MCENTEE. No.

Mr. CLAY. Could you provide for the record a copy of the circular and a copy of your letter?

Mr. MCENTEE. We will be able to do that.

If those folks are here from Texas, maybe it would be appropriate for members of the committee to ask them some questions in terms of the circular and in terms of that knowledge.

[The letter and circular follow:]

AMERICAN FEDERATION OF STATE, COUNTY
AND MUNICIPAL EMPLOYEES,
Washington, D.C., June 2, 1982.

Mr. BRUCE HINEMAN,
Executive Secretary, Teachers Retirement System of Texas,
Austin, Tex.

DEAR MR. HINEMAN: On may 13, it is my understanding that the administration of the Teachers Retirement System (TRS) sent out an "Update" to TRS participants which contained much incorrect information regarding H.R. 4929, the Public Employee Pension Plan Reporting and Accountability Act of 1982 (PEPPRA).

Your "Update" which apparently prompted many TRS participants to contact their Congressman in opposition to the measure stated that H.R. 4929 would, among other things, "override existing state constitutional protections for members and annuitants, provide a means to allow investment of retirement funds at lower rates for social purposes (e.g. to bail out insolvent governmental units with low cost loans), place federal controls on state and local government employee benefits (and) open confidential individual accounts to public disclosure." In fact, as I assume you are now aware, H.R. 4929 does not accomplish any of these undesirable objectives. As indicated in the attached Fact Sheet on PEPPRA prepared by the House Subcommittee on Labor-Management Relations, the bill does not override any existing state protections for TRS members and annuitants, does not provide a means to permit the investment of plan assets at lower rates for social purposes, does not affect any state law relating to plan benefits, nor does it open information relating to an individual's benefit to public disclosure.

My union and numerous other organizations representing public plan participants and beneficiaries, including the National Retired Teachers Association, the National Education Association and the American Federal of Teachers, have worked long and hard for enactment of the PEPPRA bill. We believe the measure which prescribes minimum reporting, disclosure and fiduciary standards for state and local government retirement systems is clearly in the interest not only of public plan participants and beneficiaries, but also of the public at large which has every right to know how well state and local government pension plan assets are being managed.

While I recognize that reasonable people can disagree over the bill's merits, I would hope that both proponents and opponents of the PEPPRA bill would confine the debate to issues which have some basis in fact. As a public official, I believe you have a responsibility to TRS participants to set the record straight regarding what this legislation would do. Accordingly, I assume that you will act quickly and responsibly to inform TRS participants of the misstatements contained in your "Update" and in any other written communications to TRS members and annuitants.

Sincerely yours,

Gerald W. McEntee,
International President.

Attachment.

[From Teacher Retirement System of Texas—Up-Date—Vol. 3, No. 8, May 13, 1982]

URGENT!

PERISA (WITH NAME CHANGE) PASSES COMMITTEE; MAY COME TO HOUSE VOTE NEXT WEEK

The House Education and Labor Committee this week passed a Public Employee Retirement Income Security Act (PERISA), HR 4928 and 4929, virtually as originally writtern. The name was changed to "Public Employee Pension Plan Reporting and Accountability Act of 1982" (PEPPRAA).

Organizations which have been opposing PERISA are predicting passage of PEPPRAA unless a major lobby effort is launched. Bill sponsors hope to get the bill to the House floor next week.

The bill would

1. Override existing state constitutional protections for members and annuitants.
2. Increase costs of administering TRS, diverting funds which could otherwise be used for benefit increases.
3. Provide a means to allow investment of retirement funds at lower rates for social purposes (e.g. to bail out insolvent governmental units with low cost loans).
4. Place federal controls on state and local government employee benefits.
5. Open confidential individual accounts to public disclosure.

TRS members who want to express opposition to federal control should contact their congressmen immediately. Please make every effort to get the word to your employees.

Mr. **Clay**. Thank you.

Mr. Bartlett.

Mr. **Bartlett**. Thank you, Mr. Chairman.

I may or may not have a full list in my file. I may or may not have the circular you are talking about. I do have something entitled "Public Employees and Teachers in Texas Oppose Federal Regulations of Public Pensions."

My questions will relate to some of the differences of opinion as to what Federal legislation would do and what it should do.

For example, as I read the bill from last year in the circular, it states that it would permit the U.S. Secretary of Labor to issue regulations and grant exceptions which would permit public pension funds to be used to bail out financially troubled States and local governments.

Is that your understanding of the legislation that the Secretary of Labor would have such exception?

Mr. McEntee. No, it is not.

Mr. Bartlett. Do you believe this legislation should provide that authority to the Secretary of Labor, to make an exception?

Mr. McEntee. No, I don't think there should be a piece of Federal legislation to do that. Of course, that opens up the whole question of social investment.

It even opens up the whole question in terms of national industrial policy and the utilization of pension monies in that area.

We think that the first reason for investment is a decent return on behalf of those annuitants and those beneficiaries within the system.

As we move to the possibilities of social investment in terms of an idea, and the jury is still out on that concept, we think that even underscores the importance of people having this kind of information.

We have watched some of the utilization of these pension monies in the past. Penna is an example, if you will, where utilization of teacher contributions in that retirement system were used to put together a package to bring in Volkswagen from Germany.

It turned out to be most appropriate in terms of the industrial plans of the State and indeed the investment returns to the people, but we didn't know that. Nobody knew that because it involved just a few people in the room putting together that type of industrial package.

These are the kinds of things we wanted to guard against, so at least the information, basic information, the basic right to know, is available to participants.

Mr. Clay. Will the gentleman yield on that point.

Mr. Bartlett. Yes.

Mr. Clay. As I interpret the bill that we had, any State would have had to come to this Congress and get permission in order to bail out any subdivision such as New York did.

Presently there is no regulation, they can use their monies any way they want to. We are talking about some kind of standard here.

Mr. Bartlett. Thank you, Mr. Chairman.

I think there is no Federal legislation, but the constitution of the State of Texas in 1976 does have that provision.

I suppose the concern of those in the State of Texas is that that would soften or dilute that current prohibition.

I concur with you, I think the primary obligation of the retirement system should be to provide for the retirees and, therefore, the maximum return on investment would be the primary obligation and there should not be any exception.

My next question is: What progress do you see being made at the State and local level and what efforts has your organization made toward convincing State and local organizations to provide full disclosure and full reporting?

Mr. McEntee. We see very little improvement. We do see some improvement in the large major State plans. We see that because in some places we have been able to force ourselves, as an institution and as a union representing these people, into the process and into the procedure.

Let me give you another example. Let me talk about Pennsylvania again for a moment, if I may.

The contributions of State employees, as opposed to teachers, in Pennsylvania for many years would go into the system and they had no money manager in the system.

All of the money in the system was controlled by the Mellon Bank in Pittsburgh. As a result, the investment returns were an absolute disaster.

Our union, through the process of negotiation was eventually able to get some participation in the State employee retirement system.

When we did we moved for a process of having a professional money manager begin to deal with the investments, the contributions, the earnings of the participants in the plan.

As a result of this, it has improved dramatically. This is based on the fact that AFSCME pushed for this kind of process. I know the teachers pushed for it in many areas.

On the other side of the coin in the same State of Pennsylvania there are 2,000 pension plans and systems covering local government workers, and we have no input into those plans, we do not know what the plans entail, we do not know the investment procedures and processes of the plan.

In some situations across the country our people don't know the most basic informaiton about their plans. We have difficulty getting booklets to tell us what the plans are in terms of levels of benefits to be provided to our people.

In many cases we get "If you are *x*, if you work *y*, you get *z*." That is the extent of the information.

What we are talking about is having information, having a right to know.

Ms. TARR-WHELAN. NEA affiliates exist in all 50 States and in all 50 States lobby their State legislature for some of the provisions of this bill as well as improvement in the retirement system.

I think that the example presented by the two researchers are fairly clear as far as how well progress has been made. It is a continuous process.

We share the same kind of examples that Mr. McEntee is talking about. Regardless of how we keep working at it, there seems to be resistance coming the other way.

I mentioned in my testimony that it seems very strange to hear representatives of the State legislators group in town talking about how the States want to improve this so badly and they are all working on this so much, at the same time resist a piece of legislation which would in fact allow States who meet the standards to opt out of that legislation.

I think in part you can't have it both ways. We will keep working at the State level even after the legislation passes, but we also feel that there need to be standards at the national level.

Mr. BARTLETT. I want to make sure I understand the organization's position.

You do not only endorse reporting, disclosure, and fiduciary requirements, but I believe I heard you also endorse vesting, portability and national standards in the sense that there would be the same standard reporting for every system in the country using the same definition and same terminology.

I am not trying to put words in your mouth, but I understand you would simply go beyond reporting and disclosure and fiduciary?

Ms. TARR-WHELAN. I believe my testimony is that they should be explored and they are of concern to our members. We have testified every time we come before the committee.

As to whether they need to be in the same piece of legislation, we will be glad to work with the members of the committee.

Mr. MCENTEE. Our concern is immediate. We believe that the legislation as put forth is a first step.

Of course, we are concerned about portability. We are concerned about vesting. We think that at least if we have the information, we can legitimately begin to attack these kinds of problems at the State and local government level.

We see the legislation as proposed in terms of the reporting process and certify fiduciary standards as being a legitimate first step and these are our immediate goals.

Mr. BARTLETT. Thank you, Mr. Chairman.

Mr. RANGEL [presiding]. Mr. Pickle.

Mr. PICKLE. No questions, Mr. Chairman. I believe I understand their position.

Mr. RANGEL. Let me ask, I hope I didn't miss it, but since you are primarily concerned with the protection of the public employees, the State and local level, how do the unions such as yours attempt to get the States to provide the protections or to reach the standards that you are seeking from the Federal Government?

Mr. MCENTEE. We try to do it in a variety of ways. You may very well try to do it through the process of collective bargaining if you are strong enough at the table.

Then in addition, you try to proceed through various State legislatures and State general assemblies to have legislation passed at that level or you can also proceed to a city council or you can proceed to a local school committee.

Our success in terms of legislation and the pursuit of legislation in States to do this, let me tell you, is nil. We have not been successful at all in being able to do it with rare, rare exceptions.

You have a legislative process you are dealing with in 50 States pertaining to the State sector. You may separate the State sector from the teacher retirement system. You may separate the teacher retirement system from the local government system.

You are dealing with a multiplicity of employees. In Pennsylvania alone there are 2,000 employers and there are all kinds of dynamics involved in a particular situation.

In California, when we talk about the improvements we saw where the legislature in the State of California did in fact move for improvement. They moved for money managers, investment counselors within the structure of their pension system.

The Governor vetoed it, so it didn't happen. You have that problem to deal with.

I stand before you with an unsuccessful record in terms of being able to accomplish this in 50 States with a multiplicity of employers in those individual States.

Mr. **Rangel**. Has there been an initiative in the city or State of New York in order to get the report and disclosure requirement?

Mr. **McEntee**. I believe we have it in the city. In the city we are on the city employee retirement board. We have representatives and were able to do that in a city like New York.

As you know, it is a large union. We are well organized in the city of New York. In that case we have been able to do it and have been successful.

Mr. **Rangel**. If city employees were to retire today, the city would be unable to tell them for 6 months as to the actual benefits?

Mr. **McEntee**. That is possible. In New York City it took us 2 years to find out how many people worked for the city of New York.

So, I don't doubt that.

Mr. **Rangel**. Have any of you taken a look at the catch-22 that we in the Federal Government find ourselves in regarding the enforcement of Internal Revenue Code public plan tax qualification provisions.

Mr. **McEntee**. This is Charles Loveless from our staff.

Mr. **Loveless**. Mr. Chairman, as you are well aware, ERISA clearly requires that public plans are to comply with pre-ERISA nondiscrimination and other qualification requirements.

Rather than disqualify members of the plan since 1977 the IRS has said that it has studied this issue and in the meantime has not raised issues of discrimination involving public plans.

Mr. **Rangel**. The union would not be asking for enforcement of the IRS provisions?

Mr. **Loveless**. What we would be asking for, Mr. Chairman, if we think the IRS qualification standards in the public sector should be reformed so as to address the true conditions in the public sector. The qualification standards as now set forth are basically designed for corporate plans.

Mr. **Rangel**. If you did change the standards, would you not also recommend changes in the sanctions.

Mr. **Loveless**. We think that question does have to be addressed and obviously it does present some troublesome problems because in many cases you will be going against individual plan participants.

That does represent a problem. The Internal Revenue Service is doing nothing in this area. There are some compelling public policy reasons why the Ways and Means Committee should be looking into this matter.

As the situation is right now, the IRS is not enforcing the requirements. The study that the Internal Revenue Service is supposed to be doing, in fact, is nonexistent.

My guess is that they are just avoiding dealing with the entire issue.

Mr. **Rangel**. If the IRS was to come to you and ask how they should handle the nondiscrimination provisions of the code, what would you recommend?

Mr. **Loveless**. We would recommend the standard be reformed to reflect more accurately the true conditions that exist in the public sector.

We think the qualification standards designed to carry this out could be protected by realistic standards.

I might say I think there is substantial question that the IRS may have the authority right now to promulgate such standards as part of the current standards for private pension plans.

Mr. **Rangel**. If they would want your input, and you know there are differences between the standard pension plans for most government employees and pension plans for elected officials, judges and so forth. Those differences sound a little discriminatory to me, how would you handle it?

If we got IRS to enforce existing law, how would you handle the antidiscrimination clauses?

Mr. **Loveless**. The most troublesome aspect of this is the problem that in most cases you are going to find them going against individual plan participants.

We think there are some important policies that are there. Nondiscrimination policies are important and should be supported. I think we will have to look into this whole area.

One suggestion we might make is that the committee should consider doing a serious study of the qualification standards as they apply to the public sector. IRS is not doing so.

We would be willing to put input into that study. We would say there is an important public policy in terms of preventing discrimination.

Mr. **Rangel**. Because of what the political title should be?

Mr. **Loveless**. That is not my——

Mr. **McEntee**. That is true regardless of their political titles.

Mr. **Rangel**. I find members of Congress being more courageous than State legislative officials.

I don't ever recall the State legislative issue being raised. I am glad it was.

It is a difficult issue and we on the Ways and Means Committee have no problems in joining the issue, but I do hope you give some serious thought to the reporting rules, prohibited transaction rules, anti-discrimination rules and certainly the matter of so, called social investment of pension funds.

IRS is having a problem enforcing existing rules. It would help to make it a lot easier for us to focus on where the problems are and have the benefit of your thinking because I rely very heavily and my colleagues on Mr. Clay's subcommittee and I should be relying on those of you who have to respond to your constituency.

My only problem is why it doesn't appear to me that your constituency is not the same constituency of the elected officials. Why they should not want to have the very highest standards of reporting and accountability for the right of the voters.

Mr. **McEntee**. We have the same question.

Mr. **Schaitberger**. Mr. Chairman, I would like to suggest an additional focus that I think is often lost in the discussion concerning PERISA or PEPPRA.

That is the concern of some who are opposed to the larger ramifications of a bill where the Federal Government may be found to be justified in regulating State and local government.

I think there are many organizations, I would suggest several in the State and local governmental areas, that view PEPPRA and a possible constitutional question when PEPPRA is enacted and if the courts, as we believe, would uphold the Congress in its authority to regulate in this area, I think that there are fears that this would then set the stage for Federal regulation in other areas where it had been either found not to be appropriate or where the legislative process had been reluctant to move forward on the question because of the fear of the Supreme Court's position.

Mr. RANGEL. Mr. Schaitberger, while academic people can argue as to whether or not the States have the constitutional protection from the Federal Government, I don't think they can effectively argue that the employee benefits enjoy the same constitutional protection as relates to Federal taxes.

Mr. SCHAITBERGER. I agree with you. The Fire Fighters International also agrees that this is an appropriate area for Congress.

I am suggesting to the members of the committee that I am personally aware of fears in other areas that such a proposal may set the stage for other interests affecting State and local governments. I believe that is an underlying concern that is rarely raised.

Mr. PICKLE. What areas are those?

Mr. SCHAITBERGER. The application, for example, of a national collective bargaining bill.

During the Fair Labor Standards Act Amendments of 1974 the Courts ruled that the Federal Government did not in fact, or the Congress had exceeded its authority in extending those standards.

We think that was the wrong decision and have consistently thought that was a wrong decision. That has put a damper, to say the least, on the interest for a national collective bargaining bill.

Possibly the enactment of any Federal legislation affecting State and local governments as it affects its relationship with its employees could be looked upon as setting a stage for movement in other areas.

Mr. RANGEL. Let me thank the Fire Fighters Union for working so closely with the Ways and Means as relates to the tax reform bill.

I hope the staff has told you that we have raised the question of trying to remedy certain unattended effects on firefighters and on public safety employees as a result off pension provisions enacted last year.

We have received assurances of the Chair that if we can't do it this year, it will have high priority next year.

Mr. SCHAITBERGER. We realize that and we thank you.

Mr. RANGEL. If there are no further questions, let me thank you for your input and your valued testimony.

Mr. MCENTEE. Thank you.

Mr. RANGEL. Let me thank the IRS for delaying their testimony while I was out of the room.

I ask S. Allen Winborne, Assistant Commissioner for Employee Plans and Exempt Organizations, to come to the witness table.

We have your prepared testimony, and certainly I guess a lot of people have covered your points, which may be submitted for the record.

You may proceed in any way you feel comfortable.

STATEMENT OF S. ALLEN WINBORNE, ASSISTANT COMMISSIONER OF INTERNAL REVENUE (EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS), ACCOMPANIED BY IRA COHEN, DIRECTOR, ACTUARIAL DIVISION, AND BILL POSNER, SPECIAL ASSISTANT FOR EMPLOYEE PLAN MATTERS

Mr. **Winborne**. Thank you very much.

It is a pleasure to be here with you and with members of both subcommittees.

You are quite right, I came in with 10 pages prepared to read every word of the 10 pages, but I do think that it has been significantly covered.

I would like to set the record straight as to some comments that were made by one of the members of the last panel about the study.

It is true that back in 1977 we issued a notice that we were undertaking a study. We undertook that study and for several years now the tentative results have been in written form.

I might add through two different administrations and through two different commissioners the matter has been further studied including the complexity of the problems that have been brought out here today by a number of the witnesses and some of the questions that have come to the panel.

It is easy when you are sitting outside the IRS to say the Service can do it, but as we look at many of the areas, I think we certainly tend to agree that ERISA was designed primarily for the private sector.

As we move into the so-called governmental retirement plan area, the very sanctions that make ERISA work—we think—so well in the so-called private business sector just aren't here.

The opportunity to make a contribution and deduct that for tax purposes just isn't here because, as we all know, the governmental organizations simply don't pay taxes.

Even if we could demonstrate and apply the remainder of our pre-ERISA rules to governmental plans, as has been pointed out several times here today, we would be aiming at and hitting those people least responsible for any problems of those plans; that is, the employee participants in those plans.

We have done that on rare occasions in the so-called business private sector. It is not a thing we like to do. We like to think we are in the business of saving plans, and we think we have saved a number of plans by ordering and gaining appropriate rearrangement of those performing operations of those plans.

It is a difficult situation. The matter is being studied. There is before the Commissioner of Internal Revenue at this moment a rather significant package with our best thoughts to this date.

We hope that we will be moving and coming up with something more than we have done.

We realize that we have not given a great deal of assistance to these committees in the past. It is not because we have not tried, and I might add this effort started before I became associated with and involved in this area of activity.

There are other problems we have encountered. These governmental plans are not subject to the minimum funding standards of ERISA.

This is something we are quite concerned about ordinarily in the so-called private sector plans. Here we don't have the authority of that ERISA provision to use in keeping the Government plans in compliance.

Beyond that, I really don't think it would be of much benefit to this committee for me to continue as we have passed the magic hour that I heard mentioned by Chairman Clay a couple times earlier. I know you have some people left to appear. With that, let me state that members of my staff who accompany me today—Ira Cohen, who is the actuary, and my personal assistant, Bill Posner, and other members of my staff along with, I am told, appropriate members of the Tax Legislative Council staff in Treasury—will be willing to work with members of your staffs in any kind of legislative program or thinking that you might have.

We will be happy to assist in any way we possibly can.

I think with that I will conclude my comments and allow you to ask questions if you have some. We will do our best to answer them.

[The statement of Mr. Winborne follows:]

Statement of S. Allen Winborne, Assistant Commissioner—Employee Plans and Exempt Organizations

Mr. Chairman of the Subcommittee on Oversight, Mr. Chairman of the Subcommittee on Labor-Management Relations and members of the Subcommittees, I am pleased to have this opportunity to be here today to discuss retirement plans maintained by governmental entities. Accompanying me today are Ira Cohen, Director of the Actuarial Division and Bill Posner, my Special Assistant for Employee Plan Matters.

First of all, I will discuss the tax treatment of public retirement plans both prior to and after the Employee Retirement Income Security Act of 1974 (ERISA). Then I will explain the problems associated with these rules that are unique to public sector plans and the difficulties the Service has had concerning their administration. Finally, I will focus on your concerns regarding the growth, scope, financial status, and the reporting and disclosure requirements relating to government plans.

TAX TREATMENT

It is a well established principle that a trust or other arrangement that is part of a retirement plan is tax exempt if the plan meets the requirements of section 401(a) of the Internal Revenue Code. Such plans are commonly referred to as qualified plans. In light of the fact that governmental entities generally enjoy tax exempt status, it is relevant to inquire whether the qualification requirements of the Code apply to government plans and, if so, what is their significance.

To address the significance of plan qualification first, in exchange for satisfying certain specified requirements, including the requirement that a plan may not discriminate in favor of officers, shareholders or highly compensated employees, special tax treatment is provided. This special treatment goes well beyond the tax exempt treatment of trust income. For example, if a plan is qualified, employer contributions to such plan are, within broad limits, fully deductible when made and favorable tax treatment is afforded to the employees who participate in the plan. Thus, employees are not taxed on the retirement benefits provided until plan distributions are actually made; if the distribution is in the form of a lump sum payment, it may be entitled to the special 10 year averaging method or the tax-free rollover provisions described in the Code; and any death benefit paid to a beneficiary, subject to certain limits, is not subject to estate tax. On the other hand, if the plan is not qualified, the employer may lose current tax deductions; the employee is taxable on employer contributions when made if there is no substantial risk that plan benefits will be forfeited; and trust income is taxable.

Although a tax deduction for contributions made under a qualified plan is of no significance to a government, the special tax benefits provided employees under a qualified plan may be very important to the employees of the government.

Regarding the question whether public employee plans must satisfy the qualification requirements of the Code, some have argued that plan qualification is not relevant to the plan of a governmental entity because the tax status of the plan's trust does not rest on the qualification rules which provide the basis for the exempt status of a private sector employees' plan trust. Instead, it is claimed that the tax exemption of a governmental trust is derived from the Constitution and Internal Revenue Code provisions which exempt from federal taxation any income derived from the exercise by a state or municipality of its governmental functions.

However, even if the trust were to be viewed as nontaxable because it falls within the exemption afforded governmental entities, this umbrella does not extent to the tax status of participants' benefits. Therefore, it has been our long-standing position—first expressed in a 1972 Revenue Ruling issued two years before the enactment of ERISA—that an employee retirement plan is not automatically qualified merely because the employer is a state or political subdivision thereof.

Under the qualification rules, qualified pension plans of governments must, among other things, be for the exclusive benefit of employees, provide definitely determinable benefits, satisfy certain anti-discriminatory rules and provide full vesting on discontinuance or termination of the plan.

ERISA's impact on government plans was not so much to impose additional requirements, as to cause both the Service and governments to focus on the fact that there were indeed qualification standards that applied to government plans. For example, section 410(c) of the Code as enacted by ERISA provides that government plans must satisfy the pre-ERISA requirements pertaining to coverage. Similarly, government plans must satisfy the rules with regard to nondiscrimination in contributions or benefits and, under section 411(e) of the Code as enacted by ERISA, the requirement for full vesting on plan termination. However, the minimum elgibility, vesting and funding standards of ERISA were not applied to government plans; neither were the requirements for joint and survivor annuities. One qualification provision added by ERISA that is applicable to all plans, public and private, is the provision imposing maximum limits on contributions and benefits.

Acknowledging that the qualification requirements apply to government plans does not mean that the administration of the qualification rules is without its problems and complexities. For example, establishing the general applicability of the qualification requirements to government plans is not necessarily dispositive of the question as to how the anti-discrimination rules are to be applied to such plans.

The anti-discrimination requirements, which are party of the pre-ERISA Code provisions, are designed to prevent plans from discriminating in favor of employees who are officers, shareholders, or highly compensated. The prohibited discrimination relates both to coverage and plan contributions or benefits. If these requirements apply to a public employees' plan in the same way as to a private sector plan, that could mean that a public employees' plan, which covers only elected or appointed officials or provides such officials with more liberal benefits than are provided for lower paid employees working for the same governmental entity, would be unable to achieve qualified status.

Also, a special situation exists if a retirment plan maintained by a state or local government does not meet the qualification requirements. This is because, as I previously stated, the income of a governmental entity is generally exempt from tax under the Internal Revenue Code. It is not clear whether a trust that funds a nonqualified governmental retirement plan also shares in this tax exemption.

Because of the complex and unique problems of applying the antidiscrimination and taxability provisions of the Code to government plans, the Service announced in Information Release 1869, dated August 10, 1977, that these issues would not be raised with respect to a government plan until a study of these matters is completed. Pending the completion of the study, the Service stated that it would resolve these issues in favor of the taxpayer or governmental unit.

The prohibited transaction rules for government plans present other problems. Violation of these rules results in disqualification for government plans as compared to imposition of an excise tax for violation of the prohibited transaction rules for private sector plans. Furthermore, an administrative exemption from the prohibited transaction rules may be granted with respect to private sector plans, but not for government plans. Although the prohibited transaction rules for government plans are generally easier to comply with than the rules applicable to private sector plans, it is possible for a government plan to be disqualified for a prohibited transaction fcr which an administrative exemption might be obtained with respect to a similar transaction involving a private sector plan.

We are very concerned that vigorous Service applications of the qualification rules, including the prohibited transaction rules, to government plans would impact almost solely on plan participants. As I indicated earlier, the loss of a tax deduction because of plan disqualification is of no significance to a government. Thus, assuming the trust would remain non-taxable, the sole consequence of disqualifying a government plan would be to tax the plan participants currently on their vested retirement benefits.

We are also concerned that vigorous Service applications of the qualification rules might motivate many governments to switch to a nonqualified unfunded plan to avoid having their employees currently taxed on the benefits they accrue. As I previously mentioned, the minimum funding standards of ERISA, which apply to most qualified and nonqualified plans, were not extended to government plans.

The consequences of switching to a nonqualified plan (i.e., loss of a favored rate of taxation for some employees on distribution of plan benefits and the loss of an estate tax exclusion) are not enough of a deterrent to many governments who wish to provide elected or appointed officials with greater benefits than other employees or who do not wish to adhere to the requirements for qualification. For private sector employers, the price of using a nonqualified plan is greater in that they must still fund the plans in accordance with the minimum funding standards of ERISA but, nevertheless, may not be entitled to a current tax deduction.

It may be that no satisfactory resolution of the issues and problems I have enumerated will be possible without additional legislation expressly addressed to government plans. Although the Service has not made any legislative proposals to the Treasury Department in this regard to the present time, I am sure the staff of the Tax Legislative Counsel under the Assistant Secretary for Tax Policy at the Treasury Department, and my staff, would be happy to work with your Committees on legislative initiatives that may be taken, or comment on any proposals you may develop.

DETERMINATION LETTER AND EXAMINATION PROGRAMS

With regard to the Service's activities concerning plan qualification and othe employee plan requirements, the Service conducts two basic programs: The determination letter program, and the examination program.

Under the Service's determination letter program, our key district offices review plans voluntarily submitted to determine whether the plans meet the requirements for qualification under the Code. Employers and other plan administrators are permitted, but not required, to apply for such a review when the plan is initially adopted, amended or terminated. Employers generally request a determination letter because having a favorable determination letter provides substantial protection against the retroactive loss of tax benefits. However, as I previously mentioned, in the case of a government, the tax benefits that are protected relate primarily to the employees rather than to the government employer.

The Service's examination program complements the determination letter program and permits the Service to ascertain whether a plan is operating in compliance with the requirements of the Code. The Service examines approximately 18,000 retirement plans annually. Most of the examinations result from the classification and selection of employee plan returns (Form 5500 series) at the IRS centers. However, many examinations are generated either by referral from Internal Revenue Agents who question a deduction for contributions to a plan during an income tax examination or by information received by the Department of Labor, the Pension Benefit Guaranty Corporation or other source. In addition, we also conduct examinations as a result of special projects. Because of limitations of resources available to conduct our examination program we give priority to the examination of plans that we believe have a significant probability of abuse stemming from noncompliance with the requirements of the Code.

In view of the fact that tax deductions are not claimed for government plan contributions and, currently, no issues are being raised regarding taxation of income earned by the plan's trust, the impact of nonqualification of such a plan would fall solely on the plan participants. Consequently, we have not examined a significant number of government plans in recent years.

REPORTING, DISCLOSURE, ET CETERA

After the passage of ERISA many administrators of government plans were uncertain of their responsibilities to file annual reports. As early as September 30, 1975, the Service published a notice in the Federal Register which included a copy of the annual report (Form 5500 series) with instructions that indicated that government plans were required to file annual reports. In a series of information releases and special announcements issued during 1977 and 1978, the service informed governmental units of these filing requirements, the relaxation of certain information requirements on the annual report, and the extension of deadlines for submitting such returns. Also, beginning in 1978 the Service designed a special return (Form 5500–G) for government and church plans to file which eliminated reporting that was not applicable to those plans.

During this time many governmental units questioned the Service's authority, as well as the constitutionality, of applying the ERISA reporting requirements to state and local governments. Litigation on this issue was decided in favor of the Service in *The State of California* v. *Regan* 641 F2d 721 (1981).

However, beginning with the 1982 plan year, the Service announced the discontinuance of the annual information return for government and church plans. This was done because our utilization of the small amount of information provided by the return, which was, in general, registration type information, did not justify the reporting burdens.

As to the disclosure of information concerning government plans, Congress, in enacting section 6104 of the Code, gave the general public, the tax writing committees of Congress, and certain state officials the right to inspect certain information relating to employee plans. Specifically, section 6104 provides that except with respect to plans having less than 26 participants an application for a favorable determination letter filed with the Service, and any supporting documents (including the plan) will be open to public inspection. Section 6104 also requires Service personnel to make available for public inspection the annual returns filed pursuant to the requirements of section 6058 of the Code. These disclosure rules also apply to government plans.

With respect to the growth, scope, and financial status of government plans since ERISA, the Service, unfortunately, is not able to provide the Subcommittees with figures that represent the universe of such plans or their financial status. The statistics available to the Service indicate that during the plan years beginning with 1978 and ending with 1981 an average of 7,300 annual returns were filed for each of those years by both government and church plans. Although we do not have a breakdown between government and church plans, it is our belief that the percentage of government plans that filed annual returns during those years is low. Also, we do not know the number of determination letters that may have been issued to government plans because no statistical breakdown is made between private and public sector plans requesting determination letters.

CONCLUSION

Based on my discussion and the fact that we are all here today, it is evident that there are many uncertainties in the area of the federal government's role, and particularly, the Service's role, in the regulation of government plans. I would like to assure you that we will be most happy to work with your Committees in resolving these uncertainties. In conclusion, I thank you for inviting me to testify. At this time my colleagues and I will be glad to try to answer any questions you may have.

Mr. RANGEL. Let me ask unanimous consent that your full statement be entered into the record at this time.

There was a time that public plans were required to report to the Federal Government and the IRS abolished the reporting.

Under what authority was that done?

Mr. WINBORNE. That really was done under the authority of the Secretary of the Treasury, which authority in turn is delegated to the Commissioner of Internal Revenue, and in turn delegated to me to require appropriate reports be filed for the appropriate administration of the tax laws.

We did reach the point where we were not carrying out very significant, effective examination programs with respect to the governmental plans.

We then were faced with the Paperwork Reduction Act of 1980. Great pressure was placed on all of the Government agencies, as I am sure you gentlemen are aware, to reduce paperwork in every possible way. We were not making use of the information at that time that was being filed. Therefore, in conjunction with our legal department, we concluded that it was the wise thing to do, that is, not to require the filing of those returns.

Mr. RANGEL. Did you ever consider the reporting provision to be a part of the public's right to know and that by eliminating the Federal filing, you were eliminating the public's right to know?

Mr. WINBORNE. I think part of our feeling at that time was that the Department of Labor is normally responsible for making such information known to the public and I think we might have relied to some extent on that.

If you would permit, I would like to consult with my assistant to see if he has a different recollection of that.

Mr. POSNER. What I would like to add is the fact that, of course, title I does have reporting and disclosure requirements that apply to Government plans.

Mr. RANGEL. They don't have to respond under title I. Then the only filing that they had to respond to was IRS pre-ERISA.

So, when that is eliminated, it is all secret.

Mr. POSNER. It is true that the IRS does not have the information to disclose.

Our perception was that the requirement in the code was a requirement to authorize the Service to require information that was needed to carry out its responsibilities.

Mr. RANGEL. Assuming that IRS knew that you were the sole reporting agency and assuming further that this was the source of information for the public when we talk about public records, did you not consider by abolishing that form that you were abolishing it for all purposes for the Federal Government since they were exempt from title I?

Mr. WINBORNE. There was another consideration, in looking at some notes I have here.

I believe when the form was revised from an earlier date, a segment of that information was not at that time required. So, the actual cessation of the requirement followed that.

Your question could be directed back to the time the form was restructured to make it more a reporting type of form than anything else.

Mr. RANGEL. Let me say that I want to keep within the spirit of cooperation that you offer to both committees to remedy what appears obviously to be an inequity.

It just seems to me that to say that the sanctions are complex and really come down on the wrong people is not a response that we should be hearing from our Federal Government.

The State representative pointed out, and I think accurately, that it is very difficult for us to tell them what their standards should be when we in the Federal Government have said that because of complexity we will not enforce existing tax law.

It just seems to me that when we do grant preferential tax treatment to any citizen that we have a responsibility to make certain that existing law is enforced and when even existing law apparently should be justified that appropriate recommendations should be made.

While union representatives and I would be reluctant to ask you to enforce the law as it presently exists, it seems to me that we should be in the forefront of saying that we want to make certain that the funds are used for the exclusive benefit of employees.

We want to make certain that we don't have discrimination in classes and we want to make certain that there is some minimum reporting as to what is being done with this money that we are not taxing.

I hope that you share with me your recommendations, at least share with the Ways and Means Committee, so that we can work with Mr. Clay to see what, if anything, can be done to address the matter.

One of the biggest fears I see with IRS is that if people don't believe that the Service is enforcing the laws fairly and equitably, then the volunteer system as we know it may be in jeopardy.

I want to thank you for the cooperation that you have given in the past. Obviously we will have to work on this in the future.

Mr. **Winborne**. I don't disagree with what you have said. I hope we can come forward with something that is worthwhile in our recommendations shortly.

Mr. **Clay**. Thank you.

Mr. **Rangel**. Thank you, Mr. Chairman.

Mr. **Clay**. There is a rule in the Internal Revenue Code that pension plan assets be used for the exclusive benefit of participants and beneficiaries.

What do you suggest, short of plan disqualification, to enforce the apparent Federal law against State and local officials who might violate this rule?

Mr. **Winborne**. Something short of disqualification?

Mr. **Clay**. Yes.

Mr. **Winborne**. In many other instances of violation or failure to conform to the law, an excise tax has been levied. I am not sure what problems you would run into if you simply levy an excise tax against a Government plan, or even against a trust of that Government plan.

Is the trust a part of that Government? Would you have a 10th amendment problem, or a problem with section 115 of the IRS Code, which provides that no tax shall be levied on income of a Government or State or subdivision thereof in carrying out its governmental affairs?

I am not sure that that would apply. Other than that, is there something that, at least in Internal Revenue Service, can be done?

There may well be equity types of litigation that could take place and perhaps the Labor Department might be more appropriate for that type of enforcement action.

It is a little awkward when the Internal Revenue Service goes into civil court on matters of that type.

Mr. **Clay**. It is a violation for these plans to use the funds to fix sewers and repair roads?

Mr. **Winborne**. Is it a violation?

Mr. **Clay**. Yes.

Mr. **Winborne**. I think there you are getting into the fiduciary standards, and if that money is put out to do this kind of work at the market rate for money and it is reasonably well protected, it might not be.

I think it is the facts and circumstances that have to be looked at each time there is activity with respect to the funds of the plan.

Mr. **Clay**. Is it being put out at market rate and is the money protected?

Mr. **Winborne**. Is it today?

Mr. **Clay**. Yes.

Mr. **Winborne**. I don't have in my possession that kind of information, Chairman Clay.

Mr. **Clay**. Why not?

Mr. **Winborne**. I think it is apparent that we have not had a very significant examination program. I suppose we have acknowledged that. We have not collected that kind of information.

Mr. **Clay**. What do you plan to do about this deficiency?

Mr. **Winborne**. I guess that will have to await what I consider the policy decisions that we are hoping can be forthcoming very shortly as a result of these studies that have been made and are now pending further consideration at the highest levels, depending on how that comes out.

If the decision there is made as a matter of policy that we should simply carry out these various rules, we might do one thing.

If it is determined that we are without authority, for all the reasons that have been mentioned here, to attempt to carry out these things vis-a-vis governmental plans, then we might have to suggest some legislation of some sort.

I can't answer that at this point.

Mr. **Clay**. Thank you.

Mr. **Rangel**. We recognize you can't answer. I suspect what you are saying when you say policy that the administration will have to come up and say how they will handle this or whether they will handle it at all or whether they believe the Congress should take the initiative.

It would seem to me, Mr. Chairman, that we should send a letter to the Secretary of the Treasury, as well as Labor, pointing out that no one argues that there is a deficiency here, no one argues that the law is not being enforced; the only question we have is what are we going to do about it?

If we are going to be cooperative, it really does not make any sense for you to be cooperative with me when they have established a policy which is contrary to cooperation.

Mr. **Winborne**. I guess we like to be sure the record doesn't indicate I came here and said the administration was not going to cooperate.

I certainly haven't said that. I have said that the matter is under study. It has been up and down the escalator, so to speak, in the agency for the purpose of study.

It is residing in the Commissioner's office at the present time. I am sure they will focus on that very shortly.

Mr. RANGEL. We will encourage that focus and hope you will report back that we are very concerned so that we can continue that cooperation.

Unless you get instructions to go down a particular line and make recommendations, then the cooperation really has not meant too much. I say that with all due respect.

Mr. WINBORNE. I understand.

Mr. CLAY. No further questions, Mr. Chairman.

Mr. RANGEL. Mr. Pickle.

Mr. PICKLE. Thank you, Mr. Chairman.

Mr. Winborne, you have made a study on this question which has been ongoing for some time, according to your earlier statement.

Have you made a copy of that available to our committee? Can we have a copy of the study you have made?

Mr. WINBORNE. I am sure we have not made a copy available to the committee. It is in the course of a preliminary draft form. The Service, as such, has made no final decision with respect to that.

Mr. PICKLE. Can we take this testimony as more or less a report of your study and your review of this question?

Mr. WINBORNE. I did not understand your question.

Mr. PICKLE. Can we take your testimony then as more or less a report on your position on this question?

Mr. WINBORNE. In my testimony I tried to make known the fact that this study is ongoing, and it has not been completed.

I have not attempted to include in my testimony or in my extemporaneous comments the thinking of that study.

Mr. PICKLE. You said there are many uncertainties in the area of the Federal Government's role and particularly the Service's role in the regulation of Government plans.

You acknowledge that and you are going to study it further. If you have any recommendations, we will be glad to get them.

Mr. WINBORNE. Indeed.

Mr. RANGEL. Mr. Bartlett.

Mr. BARTLETT. In light of what has been going on and the topheavy nature of the Civil Service plans in Federal Government, in your opinion, would the Federal Civil Service retirement system qualify as being nondiscriminatory if the IRS examined that?

Mr. WINBORNE. There are a number of different pension plans that you can find throughout the Civil Service System. Your plan is different from mine. The judges have a different plan.

All of these plans certainly raise the question of, is this discrimination? Is this discrimination in favor of what in the private business sector you would call the prohibited groups, the owners, managers?

This is part of our problem and it is a significant part of our ongoing study. A position should be taken with respect to that very question.

Mr. BARTLETT. In your opinion, would it be a prohibited group?

Mr. WINBORNE. If you want my personal opinion, as I tried to make it clear, there is no Service position on this, so, anything I state will be my own.

If you take the bare language, it appears to me it would be discrimination, but is this discrimination justified?

The basic question is, is the Federal Government in a reasonable position to tell States what they should compensate the judges, the appointed people, the executives, the others? This is all part of the problem.

It has not been taken lightly. We have looked at all of these issues.

Mr. **Bartlett**. In your opinion, the Federal Government retirement plan would not qualify people under the same standards?

Mr. **Winborne**. If it went on the same standard that we would normally look at in a private business, we would have great difficulty with it because we would find different levels of compensation, with higher levels invariably receiving much higher benefits than the so-called rank and file in Government.

Mr. **Bartlett**. That is discriminatory?

Mr. **Winborne**. That generally leads to a conclusion that a private business plan is discriminatory, yes.

Mr. **Bartlett**. Thank you.

Mr. **Rangel**. Let me thank you very much for the spirit in which your testimony was given.

I do hope you share with the policy makers that there is a gap that we are going to have to fill and we would like to do it with your cooperation.

Mr. **Winborne**. We certainly will.

I appreciate your courtesy and I have enjoyed being here.

Mr. **Rangel**. The next to the last panel, from Pennsylvnia, Lawrence Martin, executive director of the Pennsylvania Employee Retirement Study Commission, on behalf of Municipal Finance Officers Association, and William Baker, general counsel, Teacher Retirement System of Texas.

Because of the time problem, we will, without objection, enter your written and prepared remarks in the record. We ask that you highlight your testimony and summarize it so that we can use the time that is left to ask questions that are unclear.

STATEMENT OF LAWRENCE A. MARTIN, EXECUTIVE DIRECTOR, PENNSYLVANIA PUBLIC EMPLOYEE RETIREMENT STUDY COMMISSION, ON BEHALF OF MUNICIPAL FINANCE OFFICERS ASSOCIATION

Mr. **Martin**. Messrs. Chairmen and members of the subcommittees, I am Larry A. Martin, executive director, Public Employee Retirement Study Commission, Harrisburg, Pa.

I am testifying on behalf of the Municipal Finance Officers Association [MFOA] as a member of its Committee on Public Employee Retirement Administration.

We appreciate this opportunity to present the views of State and local government finance officers on the progress made nationwide, and particularly in Pennsylvania, in pension funding, investment practices, fiduciary standards, and reporting and disclosure standards.

Additionally, I will comment on the desirability of Federal involvement in State and local government retirement system matters.

The Municipal Finance Officers Association has done an in-depth analysis of State involvement in local pension plan administration, has developed a methodology for assessing a variety of State roles and has concluded that State government is the most appropriate level of government from which to initiate reforms.

It has carried out research to identify several key features of State involvement that can be used to measure and compare States.

Four of those relate to the existence of a statewide plan:

Whether it is operated by the State and available to local government?

Whether it is actuarially funded?

Whether local government is not permitted to operate their own plans?

Whether a large proportion of local governments participate in the statewide system?

It also looks at key factors relating to the State regulation of local plans where they do exist, whether there are actuarial reports on a periodic basis, and whether State-established funding standards do exist.

The final item is the existence or creation of a State pension commission.

The results of the study which concentrated on nine States concluded that the States were seeking to obtain better information on pension systems' financial condition through actuarial reporting requirements.

States were also attempting, either through State-administered systems for local governments or through State regulation of local plans, to make sure that the costs of pension benefits were fully understood, current costs were funded on a current basis and unfunded liabilities were funded on a systematic basis.

All nine States did offer statewide pension systems to local government employees. In seven of those States the funding was based on actuarial requirements. In four States there was a requirement that local government belong to the statewide system.

In these States the few local systems that do remain or which were established prior to the establishment of a State system were permitted to continue.

Locally administered retirement systems did exist in all of our study States. In six of them there were requirements that actuarial reports be submitted to the State on the status of local pension fund liability.

Standards for these reports were established in four of the States, including the State of Pennsylvania, I might add.

Among the study States, Minnesota and New Jersey imposed pension system funding requirements on locally administered plans. In other States funding, requirements were included in local charters.

In the two States of Minnesota and New York, a State agency was responsible for reviewing and commenting on all State level proposals relating to pensions.

Since the study was done prior to some substantial developments in Pennsylvania, I would like to briefly talk about Pennsylvania, a

State which is the most recent State to establish a functioning pension commission and of which I am its chief staff person.

The Commonwealth of Pennsylvania has a very decentralized and complex structure for providing pension coverage to its employees. It has a large number of local governmental units and each local government unit can establish its own pension plan.

As a consequence, there are in excess of 2,100 public employee pension plans that are functioning in the Commonwealth of Pennsylvania. This is in keeping with the basic decentralized structure of government in the Commonwealth.

These plans are primarily locally administered. They range from one benefit recipient in size to a plan of greater than 300,000 participants.

They go in asset size from a few thousand dollars to more than $5 billion. With potentially more than one-quarter of all the State and local government pension plans in the country, the Commonwealth has been viewed nationally as having a substantial public pension program.

While clearly there are continuing difficulties with Pennsylvania's complex pension structure, the Commonwealth has taken and will continue to take steps to improve its public employee pension situation.

For over a decade now, all Pennsylvania municipal pension plans have been required to report on their actuarial condition. This required actuarial reporting has functioned, first, to identify the various public employee pension plans which exist in the Commonwealth and, second, to assess the sufficiency of the funding provided to those public employee pension plans.

Data from these actuarial reports, which also includes basic financial and demographic information, is available on both the local government level and the State government level.

It also has been made available to the Federal Government through cooperation by the Commission with the Census Bureau.

I might add the Census Bureau does attempt to gather information broadly in a useful format. One of the problems with the Census Bureau's data is that it excludes any plan that does utilize insurance contracts, which, as a consequence, the data collected would greatly minimize or under, report what is going on currently in the State of Pennsylvania, where a large number of pension plans do use insurance contracts.

Mr. RANGEL. We are going to have a serious legislative problem here soon because we were supposed to adjourn at 1.

May I ask you to see whether you can summarize because I want to make certain that the members have an opportunity to ask questions.

Mr. MARTIN. Fine.

The latest development is the creation of a Pension Commission in Pennsylvania, a mandate by State legislation that the Pension Commission recommend legislation for the funding of and reporting by local pension plans and the straightening out of the pension situation in Pennsylvania.

That report has been issued. Legislation has been presented to the General Assembly, and its passage is anticipated in the very near future.

The Pension Commission provides actuarial notes on pension legislation going to the General Assembly.

The next topic that the Pension Commission will be taking a look at is the whole problem of our fiduciary liability in Pennsylvania. That would cover what is happening in Pennsylvania.

Just briefly touching, in the interest of time, on the desirability of Federal regulation, I don't believe anyone is questioning whether or not regulation is needed for reporting and fiduciary liability.

The real question of the matter is whether States ought to do it, have been doing it, and can be expected to do it in the future, and what is the most appropriate avenue for this kind of reform measure.

I think State governments are the most appropriate place for that type of public pension reform.

With that, I will conclude my testimony now, sir.

[The statement of Mr. Martin follows:]

STATEMENT OF LAWRENCE A. MARTIN, EXECUTIVE DIRECTOR, PUBLIC EMPLOYEE RETIREMENT STUDY COMMISSION, HARRISBURG, PA., ON BEHALF OF THE MUNICIPAL FINANCE OFFICERS ASSOCIATION

Messrs. Chairmen and members of the Subcommittees, I am Larry A. Martin, Executive Director, Public Employee Retirement Study Commission, Harrisburg, Pennsylvania. I am testifying on behalf of the Municipal Finance Officers Association [MFOA] as a member of its Committee on Public Employee Retirement Administration.[1]

We appreciate this opportunity to present the views of state and local government finance officers on the progress made nationwide, and particularly in Pennsylvania, in pension funding, investment practices, fiduciary standards, and reporting and disclosure standards. Additionally, I will comment on the desirability of federal involvement in state and local government retirement system matters.

The Municipal Finance Officers Association represents 9,200 members who are state and local government finance officials, appointive or elective, and public finance specialists. Included in the MFOA membership are public employee retirement system administrators, who are responsible for the day-to-day operation and supervision of public pension plans, and trustees of these plans. I feel that it is important for the Subcommittees to recognize that state and local government finance officers have many years of experience with public employee retirement systems and we are applying this expertise to the development of standards and better administration.

As financial managers in our nation's cities, counties, and state governments, we have a responsibility to plan for the long-range financing of our governments. To fulfill this responsibility, we must pay close attention to the costs and future liabilities of public employee retirement systems and make sure that they are properly administered and financed.

Prompted by the academic spirit of this hearing, I will focus my remarks on the attainment of "best practice" at the state and local levels of government. As you will see, state after state has confronted public employee retirement issues and instituted reforms tailored to solve their unique problems.

STATE ROLES IN LOCAL PENSION ADMINISTRATION

Today, I would like to spend a few minutes telling you about the Municipal Finance Officers Association's study of state roles in local financial management. Our research resulted in the first in-depth analysis of state involvement in local pension administration and developed a methodology for assessing the varieties of state roles found from state-to-state.

The unique and diverse nature of the state-local relationships examined led to MFOA researchers to conclude that no one model system for state involvement existed and the variability of local needs in the individual states supported the thesis that state governments are the most appropriate level of government from which to initiate reforms.

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[1] Questions concerning this statement should be directed to Catherine L. Spain, Director, or Cathie G. Eitelberg, Legislative Associate, Municipal Finance Officers Association, Federal Liaison Center, 1750 K Street, N.W., Suite 200, Washington, D.C., 20006, (202) 466-2014.

To carry out this original research, the Municipal Finance Officers Association staff identified seven key features of state involvement that could be used to measure and compare individual states. The first four related to the existence of a statewide plan. The specific features in this area sought to determine if a statewide retirement system, operated by the state, is available to local governments for their nonuniformed employees, and/or their uniformed employees, if the state system is actuarily funded, if local governments are not permitted to operate their own retirement plans, and if a large proportion of local governments participate in the statewide system.

The next two features related to state regulation of local plans. Specifically, participating states were asked whether or not actuarial reports on local pension plans are submitted to the state periodically, and whether or not state-established funding standards exist for local pension plans.

The last indicator used to assess state involvement was the existence of a state agency or commission with responsibility for monitoring retirement system activity statewide.

The results of this study which concentrated on nine states—California, Minnesota, Montana, New Jersey, Rhode Island, Tennessee, Texas, Washington and my own state of Pennsylvania—showed that states were seeking to obtain better information on pension system financial condition through actuarial reporting requirements. They were also attempting, either through state-administered systems for local governments or through state regulation of local plans, to make sure that the costs of pension benefits were fully understood, current costs were funded on a current basis, and unfunded liabilities were funded on a systematic basis.[2]

The specific findings of the study are summarized below. Although the data presented here are more recent than the information contained in the "House Pension Task Force Report," we should caution that additional reforms have been accomplished in the states cited. As you will hear, my own state of Pennsylvania had some problems, however, later in this testimony, I will describe the improvements that have been made in the short time since the MFOA study was conducted.

MFOA FINDINGS ON STATE INVOLVEMENT IN LOCAL PENSIONS

All nine study states offered statewide pension systems to both general and uniformed local government employees. In seven of the states, funding of the system was based on actuarial requirements. Several of this group, including Tennessee and Washington amortized large unfunded liabilities accumulated in prior years or created upon entrance of new groups of local employees into the system. In Pennsylvania and Tennessee, new member governments were given 40 years to amortize the unfunded liability they brought into the statewide system.

Four states—New Jersey, Minnesota, Washington and Montana—required local governments to belong to the statewide system. In these states, a few local systems that were in existence before the state system was established have been permitted to continue. Even though participation is not mandated in the other five states, most local governments chose to join the statewide plans, except in Pennsylvania.

In all of the states, the jurisdictions that are inclined not to participate in the statewide system are the larger cities and counties. These units have a sufficient number of employees and sufficiently large pension funds in their own jurisdictions to gain the economies of scale associated with a statewide system.

Pennsylvania is an anomoly in that only about 10 percent of its local governments initially joined the state system. The current system in Pennyslvania was preceded by a retirement plan that had inferior benefits and returns on investment for contributions. In the early 1970s, the current system was implemented to ameliorate these difficulties. It offered favorable contribution rates, benefits, and investment returns, but it operated under the stigma of its predecessor. Many smaller local governments in Pennsylvania did not join the new statewide system because they already offered retirement benefits through their own plans or annuity programs administered by insurance companies.

Locally administered retirement systems existed in all the study states. In six of the states—California, Minnesota, New Jersey, Pennsylvania, Rhode Island and Washington—local governments were required to submit actuarial reports to the state on the status of local pension liabilities. Standards for preparing these reports were established in Minnesota, New Jersey, Pennsylvania and Washington. At the time the study was conducted, the reporting requirement was new in Pennsylvania, California and Rhode Island, and no reports had yet been submitted in the latter two states.

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[2] See John E. Petersen, C. Wayne Stallings, Catherine L. Spain, "State Roles in Local Government Financial Management: A Comparative Analysis" (Washington: Government Finance Research Center, Municipal Finance Officers Association, June 1979).

Among the study states, Minnesota and New Jersey imposed pension system funding requirements on locally administered plans. In the state of Washington, funding requirements were included in the municipal charters of those cities that retain their own systems. Similarly, locally administered plans in Texas and California were often found to be funded actuarially, based on custom and charter requirements.

In two states—Minnesota and New Jersey—a state agency was responsible for reviewing and commenting on all state-level proposals relating to pensions. A pension study commission with similar authority had been proposed in Pennsylvania at the time of the study.

PENNSYLVANIA EXPERIENCE

As noted previously, the Commonwealth of Pennsylvania has a very complex and decentralized structure for providing retirement coverage to public employees. In the year 1982, slightly more than 2,100 public employee pension plans were functioning in the Commonwealth, with membership in these plans ranging from one benefit recipient through 300,000 active and retired members. Assets of these pension plans range from a few thousand dollars to in excess of $5 billion.

In keeping with the basically decentralized structure of government in the Commonwealth, governmental employing units are authorized to establish separate pension plans for their public employees. There are in excess of 4,500 local governmental units in the Commonwealth, although several of those are special municipal authorities without employees. Commonwealth law generally authorizes the provision of retirement coverage to public employees and frequently specifies or limits the provisions of the benefit plan. Where Commonwealth law does not specifically govern the benefit plan, the plan is specified by municipal charter, municipal ordinance, municipal resolution or a formally adopted plan document.

Most of Pennsylvania's pension plans are locally administered municipal pension plans. There are two large statewide pension plans in the Commonwealth, one for state employees and the other for educational (school district) employees. There also exists a state agency which is the joint administration for slightly more than 400 municipal pension plans. The remainder are essentially administered locally, with some utilizing insurance carriers and other financial entities for their administration. Some plans are insured through insurance carriers to some extent, but many are self-insured.

With potentially more than one quarter of all of the state and local government pension plans in the country, Pennsylvania has been viewed nationally as having a substantial public pension problem. While clearly there are difficulties with Pennsylvania's complex public employee pension plan structure, the Commonwealth has taken, and will continue to take, steps to improve its public pension situation.

For over a decade now, all Pennsylvania municipal pension plans have been required to report on their actuarial condition. This required actuarial reporting has functioned, first, to identify the various public employee pension plans which exists in the Commonwealth and, second, to assess the sufficiency of the funding provided to those public employee pension plans. Data from these actuarial reports, which also includes basic financial and demographic information, is available on both the local government level and the state government level. It also has been made available to the federal government through cooperation by the Commission with the Census Bureau.

In late 1981, Pennsylvania became the twenty-first state to establish a functioning pension commission, the Public Employee Retirement Study Commission. The Commission is comprised of members of the General Assembly and public members. It has professional staff and retains three consulting actuaries. The Commission is charged with coordinating the development of pension policy in the Commonwealth and with monitoring the actuarial condition of all Pennsylvania public employee pension plans. Cognizant of the actual or potential problems existing in connection with the numerous municipal pension plans, the Commission's organizing law specifically established a priority for Commission duties with respect to municipal pension plans.

In January, 1983, the Commission completed its mandated one year responsibility to formulate recommendations and legislation establishing and actuarial funding standard for all municipal pension plans and implementing a recovery program for financially distressed municipal pension plans. A report with recommendations was issued and proposed legislation based on that reports has been introduced in the General Assembly. Hearing have commenced on the proposed legislation and action on it is expected in early 1984. The proposed legislation would refine the current municipal pension plan actuarial reporting received by the Commonwealth, would establish a comprehensive requirement for municipalities to fund their pension plans, would correct inequities and inefficiencies in the current $60 million annual Commonwealth aid to municipal pension plans and would develop various local and state remedies for financially distressed municipal pension plans.

Since its creation, the Commission has met its responsibilities to provide actuarial notes to the General Assembly on any legislation affecting public employee pension plans. The actuarial note includes an assessment by one of the Commission's consulting actuaries of the actuarial impact of the proposed pension benefit changes and policy recommendations by the Commission.

In early 1984, the Commission will undertake to develop recommendations and legislation on the topic of fiduciary responsibility and liability towards public employee pension plans in the Commonwealth. Subsequent topics for future Commission consideration include a study of public employee pension benefits coverage as a component of total public sector compensation in the Commonwealth, development of recommendations and legislation on the development of intrastate portability to ease transferability of pension credit between Pennsylvania's numerous public employee pension plans and the development of recommendations and legislation on the appropriate investment authority of public employee pension plans within the Commonwealth.

The Pennsylvania Public Employee Retirement Study Commission, in late 1982, considered proposed federal legislation pending at that time and determined that its imposition of standards for reporting and disclosure and for fiduciary responsiblity was not an appropriate subject for federal legislation and would not be beneficial for Pennsylvania. The Commonwealth has demonstrated an understanding of the problems facing its public pension plans and has taken steps to address those problems. The real public employee pension problem in Pennsylvania, that of funding pension plans in municipalities which are financially distressed, can only be properly addressed with a clear understanding of the specific situation in Pennsylvania. Many of the beneficial effects intended to be accomplished by proposed federal regulation are already in place in the Commonwealth or are scheduled for consideration in the near future.

REPORTING AND DISCLOSURE

The Municipal Finance Officers Association has been engaged in activities to improve state and local pension reporting and disclosure practices. Our publication, "Disclosure Guidelines for State and Local Governments," suggests what information needs to be provided in connection with the offerings of securities by state and local governments. It provides standards that relate to all aspects of government operations including issuers' retirement systems.

Another MFOA publication, "Guidelines for the Preparation of a Public Employee Retirement System [PERS] Comprehensive Annual Financial Report," offers specific guidance on what financial statements, supporting schedules, statistical tables and other minimum disclosures are necessary to permit informed assessments of a plan's financial position and financial condition by the reports' users.

These two documents have fairly widespread acceptance as the standards to be followed and support our contention that adequate disclosure standards exist.

This leads to the question: To what degree are the standards being followed? In 1980, the MFOA's Government Finance Research Center [GFRC] prepared a study of public pension system disclosure practices for the U.S. Department of Housing and Urban Development and other cooperating agencies. It provided detailed information on the users of pension disclosure information, the authoritative and standard-setting bodies active in the pension area, and the level of disclosure found in annual reports of state and local pension plans. It is on this last point we would like to share some information from the Government Finance Research Center study, "Public Pension System Financial Disclosure".[3]

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[3] John E. Petersen, "Public Pension System Financial Disclosure" (Washington: Government Finance Research Center, 1980).

The GFRC developed a methodology whereby a survey of annual reports was made and their contents were compared to an inventory of 91 disclosure items gleaned from the recommendations of various authorities. Both the frequency of disclosure of specific items and conformance to eight particular standards were analyzed. I have attached lists of the authoritative standards consulted and disclosure items analyzed.

The results of the above analyses indicated that the level of disclosure contained in the annual reports of the 86 public pension systems studied varied greatly. While certain standards (those concentrating on accounting items and those with few requirements) tended to be followed with somewhat greater frequency, none had a commanding position. It also did not appear that disclosure was systematically related to such plan characteristics as size, level of administration, or type of employees covered in any significant manner.

The diversity of scores did show that some systems—regardless of size and level of administration—were capable of achieving high levels of disclosure. When our inventory of disclosure items was trimmed to include only that information where there were high levels of agreement among authoritative sources, the systems were scoring at or near 100 percent conformance with the prescribed standards, which represented between 10 and 20 disclosure items.

This study provided an initial review of the state-of-the-practice four years ago and should serve as the basis for further study. Proponents of federal regulations have pointed to our preliminary results, which are not conclusive, as justification for federal involvement. We believe more research is needed to assess the current level of disclosure.

TAX QUALIFICATION

The subject of tax qualification for public plans has been a controversial issue since 1972 when the Internal Revenue Service ruled that state and local pension plans were subject to Section 401(a) qualification requirements if favorable tax treatment was to be granted. With the passage of the Employee Retirement Income Security Act [ERISA] in 1974, the benefit and contribution limitations of Section 415 and the filing of an annual report (Form 5500G) were mandated.

The basic rules for qualification are:

1. The system's benefits, contributions, and coverage must not discriminate in favor of highly paid officials and employees.
2. Trust investments and income must be for the exclusive benefit of employees and beneficiaries.

Because of the wide range of public employees with different benefits, statewide systems have found it is extremely difficult to meet the two-part test.

An irony exists here. The trend of consolidating local plans into statewide systems to promote standard administrative procedure actually hinders the plans' ability to qualify for favorable tax treatment. Inherent in the consolidation process is the combining of plans with different benefit levels. A conflict therefore exists between prudent management goals and compliance with federal regulation for tax qualification purposes.

The IRS, in 1977, in recognition of the disparity between plan structures, placed a moratorium on requiring state and local plans to apply for tax qualification.

In November 1982, the IRS rescinded Form 5500G for plan years beginning after 1981 and has not issued a replacement form to date. Therefore, pubic employee retirement systems no longer report annually to the IRS.

We hope the removal of both the qualification and reporting requirements is an indication of the realization that public pension plans do not neatly fit into any one box.

Further, automatic tax qualification should be extended to state and local plans because, in our judgement, Congress never intended regulation of these governmental plans through the Internal Revenue Code. Having a clearly articulated exemption has become increasingly important to state and local plans as the 1981 and 1982 tax bills have wreaked havoc with our control over benefit levels, beneficiary annuity benefits, and withholding practices.

Automatic tax qualification should not be a "carrot on the string" or have "strings" attached to it. Let it be granted because state and local governments are the primary regulator of their pension systems.

IMPACT OF FEDERAL REGULATION

Public pensions, once commonly viewed as a governmental subfunction, have emerged as a new force in governmental finance. With public attention focused on public pension plans, the Advisory Commission on Intergovernmental Relations [ACIR] undertook a study of federal regulation in the area that resulted in a report entitled, "State and Local Pension Systems—Federal Regulatory Issues." It strongly recommended against federal regulation of state and local pension systems based on five major arguments:

1. Federal regulation may conflict with the independence states and localities require in managing employer-employee relationships. Because of the financial impact that pension benefits place on the financial health of government employers, complete control over them is essential and constitutionally guaranteed.

The 1976 Supreme Court decision, *National League of Cities* v. *Usery,* raises Constitutional questions concerning federal regulation and intervention in state and local government public employee retirement systems. In *National League of Cities [NLC],* the Court invalidated Congress' 1974 extension of the wages and hours provisions of the Fair Labor Standards Act to state and local government employees. The National League of Cities argued that these amendments were unconstitutional as they infringed upon basic state governmental functions.

2. The diverse and unique characteristics of public plans does not accommodate blanket regulation. Problems faced and solutions found in the older smoke-stack states and the sunbelt are not necessarily similar.

3. State and local pension systems have taken aggressive steps in putting their pension houses in order. In 1982, twenty-one states had active pension commissions and many others are implementing or exploring reforms.

4. There is no evidence that state and local government retirement system have adversely affected either our securities market or the national economy as a whole. Imprudent investment practices are discouraged as the financial health of a state or localities pension system directly affects its municipal bond rating.

5. Federal regulation however limited in intent can be embellished by regulatory agencies and the regulations they promulgate.

CURRENT CONDITIONS OF PUBLIC EMPLOYEE RETIREMENT SYSTEM

In 1981, two major pension studies funded by the Department of Housing and Urban Development were completed. The Urban Institute report on large systems, "The Future of State and Local Pensions," forecasted 50 years of funding levels for large public plans.[4] In general, the outlook for these plans is positive, this is "good news" especially when considering 90 percent of state and local pension plan participants are covered by these plans.

Based upon actuarial calculations and valuations at the end of each year during the 50 year period from 1977 to 2027, employer contribution rates, as a percent of payroll, fell from 12.7 percent in 1980 to 8.6 percent in 2024. Measured according to each plan's funding method and valuation assumptions but using actual experience according to standard economic assumptions, the average plan funded ratio was 56 percent in 1980 with growth to 82 percent in 2024. The Ratio of Unfunded Liability To Payroll is less than 1 for the median large plans in 1977 and will decrease to below .2 in 2027. Even if a 5 percent COLA is added, contribution rates and funded ratios are not materially affected over the next 50 years.

The second study undertaken by SRI International examined small public plans, those with under 1,000 participants.[5] The report card for these plans also shows good grades. The majority of these plans were found to be adequately funded. The report concludes that no widespread collapse of public plans is imminent. Additionally, the plans with over 500 participants appeared to be on a path that will reach full funding within 40 years, reflecting appropriate funding.

MFOA POLICY

The MFOA policy (attached) strongly supports proper reporting, disclosure and fiduciary standards while recognizing that the diverse nature of public employee retirement systems dictate that regulation is best kept at the state and local level.

In fact, federal regulation may even be counterproductive. Provisions set by the federal government may become the maximum not the minimum level of performance, thereby thwarting more progressive reforms. Additionally, the diversion of state and local resources from resolving "in-house" problems to complying with federal regulations could carry extensive administrative costs. A comprehensive study of the cost should be undertaken by the Congressional Budget Office (CBO) under P.L. 97-108 the "State and Local Government Costs Estimate Act of 1981" before any federal action is taken.

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[4] The Urban Institute, Winklevoss & Associates, and Government Finance Research Center, "The Future of State and Local Pensions," (Washington, D.C.: The Urban Institute, 1981).

[5] Arden R. Hall and William D. Smith, "Local Public Employee Pension Plans—Current Condition and Prospects for the Future," (Menlo Park, California: SRI International, 1981).

CLOSING REMARKS

We have come here today to answer questions as well as ask them. What are the specific abuses that federal regulation would be designed to correct? How many public employee retirement systems have denied benefits to participants? Is there truly a lack of information or only diverse disclosure methods that cause the appearance of a problem? Should our funding levels be the same as private pensions, considering the on-going nature of governmental entities? What will be the cost of federal regulation for state and local government?

Messrs. Chairmen, we leave you with these thoughts and express our appreciation for the opportunity to testify today, and are available for any questions you may have.

This testimony is supported by the National Association of State Retirement Administrators.

MUNICIPAL FINANCE OFFICERS ASSOCIATION

Policy Statement

Federal Regulation of Public Pension Plans

The Municipal Finance Officers Association strongly encourages the reporting and disclosure of that information needed by interested parties to accurately assess the financial operations of governments and governmental organizations.

Recognizing the special needs in the area of public employee retirement system reporting and disclosure, the Municipal Finance Officers Association, through its Committee on Public Employee Retirement Administration, developed the Guidelines for the Preparation of a Public Employee Retirement System Comprehensive Annual Financial Report. The Executive Board of the Municipal Finance Officers Association has approved the publication of these guidelines and in doing so urges the implementation of these guidelines by state and local government employee retirement systems.

The 97th Congress is deliberating enactment of legislation which would place regulation of state and local government pension plans under the jurisdiction of the U.S. Department of Labor. This legislation would impose on public pension plans certain types of standardized reports, actuarial and accounting analysis, and disclosures to plan participants in addition to establishing fiduciary standards for plan trustees, managers, and other co-fiduciaries. The Municipal Finance Officers Association believes strongly that adoption and enforcement of standards for state and local governments is the responsibility of state and local governmental units -- the units of government which have the sole responsibility for funding the retirement systems. There is no compelling evidence that these proposed standards are not now being adequately fulfilled.

While the MFOA strongly supports proper reporting and disclosure with respect to public retirement systems and proper allocation of fiduciary duties, the interaction with the federal government required by such proposed legislation would add tremendous expense to state and local pension plans -- money that otherwise could be used to pay benefits. Furthermore, the provisions of these bills would supercede all laws and constitutional protections of state and local political subdivisions.

Even though the Report of the Pension Task Force of the U.S. House of Representatives recommended federal regulation of state and local public employee retirement systems, we believe that serious constitutional questions continue to exist.

Therefore, the Municipal Finance Officers Association opposes any federal legislation regulating public employee retirement systems.

Adopted: May 25, 1982

Attachment A

We obtained guidance concerning what items should be disclosed by examining the following documents:

1. Municipal Finance Officers Association. Disclosure Guidelines for State and Local Governments (MFOA).
2. The MFOA Committee on Public Employee Retirement Administration. Public Employee Retirement Administration (PERA handbook).
3. National Committee on Governmental Accounting. Governmental Accounting, Auditing, and Financial Reporting (GAAFR). 1/
4. Accounting Principles Board. Accounting Principles Board Statement Number 8 (APB #8).
5. Financial Accounting Standards Board. Accounting and Reporting by Defined Benefit Pension Plans (FASB).
6. William R. Schwartz. Suggested Format for a Public Employee Retirement System Annual Report (Schwartz).
7. U.S. House of Representatives. Public Employee Retirement Income and Security Act of 1980. H.R. 6525 introduced February 13, 1980. (PERISA)
8. MFOA Committee on Public Employee Retirement Administration and the MFOA Certificate of Conformance Program. Guidelines for the Preparation of a Public Employee Retirement System Comprehensive Annual Financial Report (Third Draft, May 1980). (COPERA).

1/ The most recent edition of GAAFR was published in 1969. Since then the National Committee on Governmental Accounting was renamed the National Council on Governmental Accounting. Subsequently, the contents of GAAFR were modified by Statement 1: Governmental Accounting and Financial Reporting Principles. Released in 1979, Statement 1 is effective for fiscal years ending after June 30, 1980, although earlier application is encouraged.

Attachment B-1

DISCLOSURE AND REPORTING INVENTORY FOR THE COMPREHENSIVE ANNUAL REPORTS OF STATE AND LOCAL EMPLOYEE PENSION SYSTEMS

Authoritative Source of Requirement									Disclosure Percentage		
A	B	C	D	E	F	G	H		I	J	K
MFOA	PERA	GAAFR	SCHWARTZ	APB #8	FASB	PERISA	COPERA	DISCLOSURE SECTIONS AND ITEMS	not disclosed	disclosed	not available
								INTRODUCTORY SECTION			
								STRUCTURE OF THE REPORT AND ORGANIZATION AND ADMINISTRATION OF THE SYSTEM:			
	X		X				X	Table of contents	56	44	
	X		X				X	Transmittal letter	23	77	
				X	X		X	Disclosed number of contributing employers	40	60	
	X		X			X	X	Members of governing board	9	91	
								..... How selected	48	52	
								BENEFIT DESIGN:			
	O		X	X		X	X	Description of current program (includes some history)	42	58	
	•		X					..... Described employees covered (e.g., police, fire and teachers)	51	49	
			X					..... Criteria for membership in plan	67	43	
			X					..... Regular retirement criteria	57	43	
			X					.... Benefits described	64	36	
			X					..... Early retirement criteria	72	28	

A	B	C	D	E	F	G	H		I	J	K
								BENEFIT DESIGN (cont.)			
			X					_____ .... Benefits described	72	28	
			X					_____ ..... Disability retirement criteria	65	35	
			X					_____ .... Benefits described	69	31	
			X					_____ ..... Other benefits	69	31	
X					X	X		_____ ..... Legal priority of participant's claims (security of benefits)	100	0	
X	X		X		X	X	X	_____ ..... Plan amendments disclosed	60	40	
X						X	X	_____ .... Effects of amendments	66	34	
								FINANCIAL SECTION			
X	X	X	X	X	X	X	X	FINANCIAL STATEMENTS:			
								_____ Audited	43	57	
X	X	X	X	X	X		X	_____ ..... **Included auditor's opinion**	60	40	
X	X	X	X	X	X	X	X	_____ ..... Conform to GAAP	73	27	
	X÷	X	X	X	X	X:	X	_____ Report of assets, liabilities, and (if required) reserves and/or fund balance	1	99	
	X		o^1					_____ ..... PERA (with reserves and future contributions rather than fund balance)		9	
			o^1		X	X	o^1	_____ ..... FASB (statement of net assets available for benefits)		13	
		X	o^1				o^1	_____ ..... GAAFR or NCGA Statement #1 (with fund balance)		19	
								_____ ..... Other _______________		60	
	X	X	X	X	X	X	X	_____ Report of operations	3	97	
					X	X	o^1	_____ ..... FASB (statement of changes in net assets available for benefits)		13	

A	B	C	D	E	F	G	H	FINANCIAL STATEMENTS (cont.)	I	J	K
	X		X					..... PERA (leads to excess of revenues over expenditures)		15	
							O[1]	..... NCGA Statement #1 (statement of revenues, expenses, and changes in fund balance)		5	
		X						..... GAAFR (analysis of changes in fund balance)		30	
	O	X	X			X	X	..... GAAFR and PERA (statement of cash receipts and disbursements)		51	
								..... Other ______________________		3	
	X	X	X					Statement of changes in reserves	47	53	
		X						..... GAAFR		7	
	X		X					..... PERA (with future contributions of employer)		7	
								..... Other ______________________		40	
					X		X	FASB (statement of accumulated plan benefits)	91	9	
					X		X	FASB (statement of changes in accumulated plan benefits)	95	5	
	X		X				X	PERA (schedule of administrative expenses)	60	32	8
							X	Schedule of investment expenditure/expenses	90	2	8
	X	X	X	X	X	X	X	Footnotes to the financial statement	45	55	

A	B	C	D	E	F	G	H	FINANCIAL STATEMENTS (cont.)	I	J	K
X	X		X	X		X	X	_____ ..... Statement concerning historical and current internal and external factors (including litigation, trends which may significantly impact actuarial assumptions, and change in accounting method) which may impact the financing and operation of the fund	67	33	
	X	X	X	X	X		X	_____ ..... **Basis of accounting: i.e., cash, accrual, modified accrual**	57	43	
	X	X	X	X	X		X	_____ ..... Accounting for investments (e.g., cost, market, and amortized cost)	26	74	
	X	X	X	X	X	X	X	_____ ..... Accounting for insurance company contracts	1	1	98
								INVESTMENTS:			
	X		O		X			_____ Statement of investment policies and restrictions	53	47	
			O					_____ Reports investment results ($ or %)	9	11	
	X		O		X	X	X	_____ ..... Portfolio by asset type	7	93	
			O		X	X	X	_____ .... Market value given	27	83	
			O				X	_____ ..... Return by asset type	65	35	
			O				X	_____ .... Return defined	87	13	
								_____ ..... Performance evaluated	79	21	
						X	X	_____ ..... Disclosed investment managers and broker-dealers	66	34	
						X	X	_____ ..... **Amounts paid to each of the above**	92	8	

A	B	C	D	E	F	G	H		I	K	J
								FINANCING:			
X	X		X	X	X	X	X	_____ Disclosed funding policy for employers and members (this information may be in the inventory section)	42	58	
X	X		X	X	X	X	X	_____ ..... Contribution rates of employee and sponsoring government(s)	33	67	
								ACTUARIAL SECTION			
								SCOPE OF ACTUARY'S DUTIES:			
	X		X			X	X	_____ Actuary's opinion	49	51	
							X	_____ Availability of actuary's report	90	10	
X						X	X	_____ Frequency of actuarial valuations	49	51	
X	X		X		X	X	X	_____ Date of lates valuation	35	65	
								ACTUARIAL ASSUMPTIONS:			
X	X		X		X		X	_____ Changes in actuarial assumptions	73	23	3
			O				X	_____ ..... Reported effect on contributions	76	21	3

A	B	C	D	E	F	G	H	Actuarial (0/1)		Historical I	Historical J	Historical K	Actuarial I	Actuarial J	Actuarial K
X			X		X	X	X	____	Summary of major actuarial assumptions				63	37	
X							X	____	Source of decrement tables: death				66	34	
X							X	____	Source of decrement tables: disability retirement				79	21	
X							X	____	Source of decrement tables: withdrawal from service				76	24	
X			X		X		X	____	Investment returns	17	83		56	44	
X			XX		X	X	X	____	Salary increases and pay history	80	20		67	33	
X			XX		X	X	X	____	Age(s) at retirement	83	17		72	28	
X								____	Benefit changes after retirement	94	6		97	3	
X			X		X		X	____	Inflation rate (rate of growth of total salaries)	94	6		70	30	
								____	Administrative expenses*	60	32	8	92	8	
								____	Cost of other benefits*	97	3		94	6	

1/ The double X's given above apply to the historical section.

A	B	C	D	E	F	G	H	ACTUARIAL CONDITION OF FUND:	I	J	K
X						X	X	_____ Treatment of unfunded accrued liabilities	62	38	
	X		X			X	X	_____ Actuarial balance sheet	67	33	
X	X	X	X	X	X	X	X	_____ ..... Amount of liability	29	71	
X			X		X	X	X	_____ ..... Actuarial method for calculation of liability	62	38	
X							X	_____ ..... Basis of asset valuations	69	31	
			X				X	_____ Analysis of solvency test	87	13	
			O				X	_____ Analysis of actuarial experience	92	8	
						X	X	_____ Schedule of actual vs recommended contributions	66	44	
						X	X	_____ Historical schedule of active member valuation data	80	20	
							X	_____ Historical summary of funded and unfunded accrued liabilities	84	16	
							X	_____ Recommended contributions schedule	87	17	
								STATISTICAL SECTION EMPLOYEE MEMBERSHIP:			
X	X		X			X	X	_____ ..... # Active	9	91	
								_____ ..... # Active with vested benefits	77	23	
X	X		X			X		_____ ..... # Terminated from employment (yet, not retired) with vested benefits	57	43	

A	B	C	D	E	F	G	H		I	J	K
X	X		X			X		_____ ..... # Retired plus others receiving benefits (e.g., widows)	14	86	
			X					_____ ..... # Total members	35	65	
			X				X	_____ Schedule covering the classification of retired members (i.e., the type of retirement taken)	45	55	
								OTHER STATISTICAL SCHEDULES:			
			X				X	_____ Statistical schedule of expenditures/expenses by type	90	10	
			X				X	_____ Statistical schedule of revenues by source	90	10	
			O				X	_____ Statistical schedule of average benefit payment amounts	76	24	
			O				X	_____ Statistical schedule of participating employer members	27	17	55
			O					_____ Statistical schedule of additions to net real assets	73	27	
			o					_____ Statistical schedule of benefit expenses by type (includes disability, death, annuities, refunds)	28	72	

Mr. **Rangel**. Thank you.
Mr. Baker.

STATEMENT OF WILLIAM BAKER, ESQ., GENERAL COUNSEL, TEACHER RETIREMENT SYSTEM OF TEXAS; ALSO ON BEHALF OF NATIONAL CONFERENCE ON TEACHER RETIREMENT, EMPLOYEES RETIREMENT SYSTEM OF TEXAS, TEXAS MUNICIPAL RETIREMENT SYSTEM, AND TEXAS COUNTY AND DISTRICT RETIREMENT SYSTEM

Mr. **Baker**. Thank you, Mr. Chairman.

My name is William Baker, general counsel for the Teacher Retirement System of Texas.

I am also appearing to testify on behalf of other statewide public employee retirement systems in the State of Texas, the State Employees Retirement System of Texas, the Texas Municipal Retirement System, and the Texas County and District Retirement System.

Mr. Chairman, I was invited and appreciate very much the opportunity to appear before you.

The invitation came late last week. I have had no opportunity to prepare written remarks. I would hope that I may be able to submit something in the next week or so that will be much more detailed than anything I will say now.

Mr. **Rangel**. The record will be kept open for that purpose.

Mr. **Baker**. I appreciate that very much.

I also will be referring to some conclusions from a preliminary National Council on Teacher Retirement Study which is still being compiled. I would hope that report could also be submitted.

Since testimony has been given and one document entered into your records concerning what Teacher Retirement Systems of Texas put out last time on PEPPRA, that record can be more amplified, if all the relevant material put out by our system can be submitted for your records. I think that will clarify and explain the statements that were made.

Mr. Chairman, public retirement systems in Texas having statewide jurisdiction, cover in excess of 600,000 active and retired participants.

The National Council on Teacher Retirement is composed of 44 States and 15 local retirement systems for teachers and other public employees. The 44 State systems have roughly $120 billion in assets and over 5 million active participants.

We believe that these systems are well run and well regulated in general and that they are responsive to the public and to the interest of participants.

You have heard some testimony about some deficiencies in some systems. I think, from what I have been able to gather, that when you are able to sit down and look at the cold, hard facts about those systems in terms of the number of participants they cover, by and large the great number of public employees are covered by sound, well-run systems which provide information to the participants which make reports to oversight organizations, and that many others of them have very strong fiduciary responsibilities.

That, I think, would indicate that there is really no Federal crisis, no problem of national scope to justify a bill to be enacted by Congress.

The study which I made reference to has resulted in some conclusions which I think are very interesting and which might have some bearing on this conclusion.

For example, public plan provisions for the pension benefits are essentially in public statutes. They are not hidden somewhere, They are part of the public record.

In addition, plans disclose to members through the equivalent of a summary plan description. They go beyond that. They provide in many cases a great deal of information, not only about existing laws, but also proposed legislation that will affect benefits.

So, there is a great deal of disclosure made to members.

Mr. RANGEL. You are talking about Texas?

Mr. BAKER. Not only about Texas, but I think you will find that is true in many other statewide systems.

Mr. RANGEL. We want the benefit of your expertise, but you are not counsel to any other plans besides Texas?

Mr. BAKER. No, sir. What I am talking about is the result of the National Council of Teacher Retirement System's study which will be submitted to you at a later date when it is ready.

I think these conclusions are in that study. This is what I am having reference to, Mr. Chairman.

Mr. RANGEL. I am tempted to say that your testimony will be received subject to connection.

Mr. BAKER. Mr. Chairman, I am sorry if you don't want this in the record. I will refrain from saying anything.

Mr. RANGEL. It is difficult to refer to a report that will be made sometime later. If these are your general observations, they will be received.

Mr. PICKLE. We also have a hearing on legislation that has not been introduced. I hope you will let the gentleman conclude.

All morning people have made references to studies and things that were directed by their agencies. We have not questioned that authority or judgment.

I hope that the gentleman will be able to proceed.

Mr. RANGEL. I point out he refers to a study that we will have no way of finding because it is not there.

I know that in Texas they do things in a different way. If you are talking about a proposed study that I could be looking forward to, I will look forward to the study being completed the same way I will the IRS study.

Thank you.

Mr. CLAY. Will the gentleman yield?

The study that you are referring to was in regard to a specific piece of legislation, was it not?

Mr. BAKER. No, sir. It is really in its preliminary stages of its compiling.

Mr. CLAY. We are not talking about the one you did last year or year before last where you sent out questionnaires?

Did you send out a questionnaire this year?

Mr. **Baker**. The National Council on Teacher Retirement did send out a questionnaire. They followed up with phone calls. They are compiling the information.

Mr. **Clay**. Did you start out by saying the information we receive will be used to oppose any legislation in the Congress dealing with this subject?

Mr. **Baker**. It will be something you can use, I think, to get the full picture of whether there is disclosure, whether there is reporting, whether there are financial fiduciary standards in these State and local pension plans.

Mr. **Clay**. So, really if the information you will get back will be from those who are opposed to it, after you list the horrendous things that will happen if this legislation passes, what kind of information do you think you are going to receive back?

Mr. **Baker**. I think it will be facts, Mr. Clay, that you are going to get, citations of statutes, things that you can check out, things that I think will be no less biased than any other reports that will be made.

Mr. **Pickle**. Mr. Chairman, that information will be submitted and you can pass judgment on it.

We should give as much credibility to this witness as we have to those who have conducted a study on the other side of it.

Mr. **Rangel**. I want to know how long the record should remain open.

Mr. **Baker**. The 28th was your cutoff date for things to be submitted in writing; is that right?

Mr. **Rangel**. Right.

Will a report be in by then?

Mr. **Baker**. I think you can count on that. I was not asking for an extended period of time. I don't want to delay your consideration of this.

Mr. **Rangel**. You may proceed.

Mr. **Baker**. There are many layers of regulation and oversight in State and local government pension plans. There are specialized legislative committees.

There are other agencies that systems report to, such as governors, controllers, insurance boards.

In addition, there are State auditors, independent auditors. There are professional actuarial studies made not only by in-house actuaries, but by independent actuaries that are retained by the retirement system.

Also, actuaries are employed by independent organizations such as pension review boards. You have actuarial studies on many different levels.

In addition you have some informal oversight of some of the plans because of their nature. They are in the public eye. They are public agencies. So, there is more coverage by press, more attention by public employee groups.

Legislators get inquiries from participants who are voters and have a great deal of influence on the status of their plans. At least that has been my experience in the State of Texas.

State laws also give public access to trustee meetings and to records within agencies. State governments lead the way in sunshine laws, open record laws, open meeting laws. There are files and documents and information on public pension plans that are available to the public.

They are available to the public. They are available to the press. We think that is a significant advantage that the private sector participants do not enjoy.

Benefit rights are often protected by State administrative procedure acts and by State constitutional provisions, by judicial decisions, so that due process is preserved.

There are fiduciary standards in statutes and constitutions.

Often you find a version of the prudent person rule. Oftentimes it is ERISA language. Oftentimes it is a more traditional common law prudent person's rule.

There will be legal lists of investments that can be made. Oftentimes you will find a declaration that funds are held in trust.

Other State laws would impact on these considerations, ethics laws, conflict of interest laws, abuse of office provisions, bribery provisions.

Financial disclosure is often required of trustees.

State and local government is the final guarantor of the promised benefit.

I think those factors are important to consider. I hope you will receive and look at this information and look at other studies that are made and provided to you to get the full picture of the situation.

We believe that the continuing trend in the development of State and local law is to increase the protection for participants, increase the information available to the public and that you should let that work its way because I think the public interest is going to be served in doing that and those are very important considerations.

The problems which arise can be and should be dealt with at the State and local level.

[Subsequently, a prepared statement with attachments, and the preliminary report referred to were received as follows:]

STATEMENT OF WILLIAM BAKER ON BEHALF OF NATIONAL CONFERENCE ON TEACHER RETIREMENT; EMPLOYEES RETIREMENT SYSTEM OF TEXAS; TEACHER RETIREMENT SYSTEM OF TEXAS; TEXAS MUNICIPAL RETIREMENT SYSTEM; AND TEXAS COUNTY AND DISTRICT RETIREMENT SYSTEM

I am William Baker, General Counsel of the Teacher Retirement System of Texas, appearing at the invitation of your two subcommittees, to convey the concerns of the National Conference on Teacher Retirement and of four statewide public employee pension systems of the State of Texas about proposed federal regulation of state and local government employee pension plans. These four statewide systems—the Employees Retirement System of Texas, the Teacher Retirement System of Texas, the Texas Municipal Retirement System, and the Texas County and District Retirement System—alone account for almost 700,000 active and retired public employees in the State of Texas.

There is no national crisis, no set of problems of national import, to justify federal regulation of state and local government employee pension plans. Plans which cover the great majority of public employees are well-managed, responsive to their participants and beneficiaries, and are in general financially sound. Plans which are experiencing funding difficulties have disclosed this to the public and their participants. The valid complaints and problems with public pensions lie mostly with small local government plans which individually cover few employees and which in the aggregate account for a small percentage of the total number of public employees. Their problems are not of national scope. They can be, should be, and, in many cases, are being dealt with by the state and local governments responsible for them. There is no justification for attempting a federal solution to them. The states are aware of the problems of pension plans and have adequate machinery to investigate and implement solutions.

A recent survey conducted by the National Conference on Teacher Retirement of its member organizations supports these conclusions. NCTR is composed of 44 state and 15 local retirement systems which cover teachers and other public employees. The 44 state systems have roughly $120 billion in assets and over 5 million active participants. I am submitting with this testimony an analysis prepared by NCTR of the results of this survey for twelve major state systems which account for almost 2 million of these active participants.

The survey shows that proponents of federal regulation of public pension plans have serious misconceptions about the public plan environment. In arguing for federal reporting and disclosure, fiduciary standards, and various other requirements similar to those contained in PEPPRA as introduced last session, these proponents ignore a large body of existing state law which provide reporting and disclosure requirements, fiduciary and ethical standards for trustees, and due process for plan participants. They ignore the fact that substantial regulation of public plans already exists at the state level.

Public sector pension provisions are essentially found in public statutes. Their terms are readily available to the public—including participants and beneficiaries. These plans have been fashioned with (and cannot be changed without) the input of participants and beneficiaries through the political process. Their adoption and implementation takes place in public, not in secret.

Benefit rights are usually protected by other laws as well. State administrative practices acts guarantee due process in rulemaking and administrative decisions. Furthermore, state constitutions and court decisions in many states provide benefit protection even beyond that guaranteed by ERISA.

The public plans surveyed disclose accrued pension interests, provide written plan summaries, and give benefit estimates to their members on a regular basis. They conduct workshops, seminars, hold individual and group field counseling meetings with participants. They often view themselves to be service agencies for their participants and beneficiaries rather than a branch of management. Changes in benefits are disclosed quickly to those affected and, in fact, changes proposed in local, state or federal legislation are often disclosed by plan administrators even before they are adopted. The disclosure practices, whether or not required by law, are, practically speaking, more informative and useful than that required by ERISA or proposed by PEPPRA.

Public plans are subject to several layers of regulation and oversight. As a result any funding or financial problems of a state or large local system are well known. Most states now have functioning Pension Review Boards which analyze and report on the condition of the systems under their jurisdiction and often comment on proposed pension legislation. State legislatures have developed specialized legislative committees and subcommittees which consider pension matters and exercise legislative oversight. Other executive agencies receive pension plan reports and exercise various forms of supervision. These may include the state's governor, insurance board or regulatory agency, controller, or other official or agency. A state and/or an independent auditor is responsible for examining the records and transactions of plans under accepted accounting standards. Professional actuaries, perhaps on more than one level, examine the liabilities and assets of plans and report their findings to the plans, to the public and to oversight agencies.

Informal oversight public plans may be as important as formal regulation. Public plan participants and beneficiaries are generally voters. Their complaints to legislators can evoke quick response from plublic plan administrators and serve as a check on unfair or arbitrary practices. Public plans are subject to the scrutiny of lawmakers, the press, and public employee groups. Administrators and trustees must be prepared at all times to justify their actions to these informal sources of oversight.

State laws give public access to public plan records and proceedings on a scale unmatched in the private sector, even after ERISA. The states have pioneered open meetings laws, open records laws, sunshine laws, and freedom of information acts which apply to public pension plans with limited exceptions to preserve individual privacy rights of participants and to avoid untimely publicizing of investment decisions to the deteriment of a public fund. An individual participant or beneficiary has a variety of options to obtain disclosure of detailed information on the conduct of pension plan business.

States often impose explicit fiduciary duties on trustees of their public pension plans. This may be done by statute or constitution. Often a prudent person rule applies to plan investment decisions either in the form of the ERISA standard or the traditional common law standard. State laws also may prescribe lists of permissable investments or impose other requirements on plan investments. Even for those states which do not explicitly impose fiduciary duties, there may be a statutory declaration that the funds are held in trust for participants, thereby giving rise to a conclusion that a trustee's fiduciary duties apply to the management of the fund.

Other state laws which apply to the management of public pension funds by trustees and administrators include state ethics laws; laws prohibiting conflict of interest, abuse of office, bribery; and laws requiring financial disclosure by plan trustees and administrators. These laws often have significant criminal sanctions imposed for violation and may be much stricter than ERISA standards.

There is a continuing development of state and local law regarding public pension plans, especially with respect to the small systems where problems are concentrated. Progress is being made at the state and local level toward even more responsible public pension systems.

Proponents of PEPPRA or similar federal legislation often cite public pension funding problems as a reason for federal legislation. However, their proposals have yet to include any federal funding standards or requirements for public plans or to propose methods of obtaining money for underfunded systems. PEPPRA in fact would not have applied to completely unfunded systems. The underfunded public pension systems are well known. Federal legislation is not needed to expose them. Unless the federal government is willing to provide a mechanism for funding these systems—either through taxes or through some sort of risk spreading throughout public pension plans similiar to the Pension Benefit Guaranty Corporation—funding will continue to be the responsibility of the appropriate state or local government. This is as it should be. A federal funding solution would likely involve taxing those jurisdictions and taxpayers which are doing a good job funding their own plans in order to support those jurisdictions which may not be doing as good a job. Funding is a state and local responsibility which can only be fairly addressed at that level. The Federal government should have no role in this matter.

If state and local plans already disclose and report, provide due process to participants and are governed by fiduciary standards, there is no reason to impose federal standards. The burden should be on the proponents of federal regulation to show the need for the additional expense, effort, paperwork and bureaucracy which yet another level of regulation would bring. The proponents should be required to show how this additional reporting to federal agencies will be any more useful than the now abandoned reporting made by public plans to IRS on form 5500's.

Our federal system assumes that local or state governments should do the job if they can. These governments are closest to the people. State and local pension regulations can be fine tuned to the particular needs of participants and beneficiaries of a particular jurisdiction. They are adapted to the particular benefit structure provided by that jurisdiction. Federal standards would be less flexible and not as helpful to individual participants.

Federal regulation of public pension plans opens a second front for those who would support social investing. Special interests will operate not only at the state level but also at the federal level to obtain permission for or even require public fund investments in socially or politically desirable investments, even at the expense of income and safety of capital. Already many more social investment issues seem to arise in Congress than at the state level. It will be difficult for public plants to fight against these proposals on two fronts.

Our concern with social investing is especially acute if federal regulation takes the form previously contained in PEPPRA. When state statutory and constitutional protections are preempted, federal law could become the problem rather than an attempted solution. I am submitting for the record copies of material prepared by the Teacher Retirement System of Texas which outlines how PEPPRA as proposed last session would have overriden state prohibitions against social investing and permitted bailouts of insolvent governments. Any review of the recent construction of the ERISA preemption provisions by federal courts will show clearly that state laws that are more protective of employee interests than federal laws can be wiped away in the name of protecting the employee with federal regulation. The threat of future federal legislation permitting social investment as well as the preemption of state protections against social investments are reason enough to oppose federal involvement in public plan investment activity.

Federal regulation of public pension plans poses significant threats to the long-term interests of public pension participants and would needlessly complicate the administration of public employee pension plans. The is no real national interest to be served by such regulation. The principal beneficiaries of regulation will not be the public or participants, but will rather be the private interests who stand to profit by its bureaucratic requirements or who may subsequently use it as a framework to obtain access to the assets of public pension systems in this country.

The attached material concerning Federal regulation of state and local government employee pension plans was distributed by the Teacher Retirement System of Texas [TRS] during 1982:

(1) Newsletter dated April 26, 1982, detailing TRS Board of Trustees objections to PERISA and reporting that the NEA affiliated Texas State Teachers Association House of Delegates had voted to oppose federal regulation of public pensions. Sent to all TRS members.

(2) Letter dated May 6, 1982, with enclosure an open letter dated March 30, 1982, to Texas Senators and Congressmen signed by all TRS trustees opposing PERISA. Sent to the Texas Congressional delegation.

(3) Up-date dated May 13, 1982, to inform of House Education and Labor Committee action on PEPPRA. Sent to all reporting district offices whose employees are covered by TRS.

(4) Up-date May 24, 1982, to inform of progress on PEPPRA. Sent to all reporting district offices whose employees are covered by TRS.

(5) Letter dated May 24, 1982 with enclosure date May 21, 1982, giving detailed arguments in support of the TRS trustees opposition to PEPPRA, and of the brief analysis of proposed legislation made in previous Newsletter and Up-Dates. Sent to Texas Congressional delegation.

(6) Newsletter dated June 3, 1982, making further reports on and analysis of PEPPRA with special attention given to refuting claims of proponents about the legislation. Sent to all TRS members.

(7) Letter dated June 10, 1982 to respond to attempts of proponents of PEPPRA to refute TRS concerns. Sent to Texas Congressional delelgation.

(8) Undated flyer "Why Public Employees and Teachers in Texas Oppose Federal Regulation of Public Pension Plans" prepared in 1982 and containing TRS analysis of PEPPRA, a response to proponents claims about the legislation, and a reprint of an Austin American-Statesman article concerning the opposition of Texas public employees to PEPPRA. General distribution.

NEWSLETTER

TEACHER RETIREMENT SYSTEM

Austin, Texas April 26, 1982

Board Opposes PERISA, Federal Control of TRS

Recent activity in Washington on a proposed Public Employee Retirement Income Security Act (PERISA) has prompted TRS Board of Trustees to voice opposition to the bills which would provide federal control over TRS and other public pension systems.

In a letter to members of U. S. House and Senate from Texas, Trustees said that they oppose PERISA primarily because it is unnecessary, its stated goals are being achieved more effectively on the state and local level, and there is no reason to needlessly encumber public plans with bureaucracy.

Hearings have been held on PERISA bills introduced by Illinois Congressman John Erlenborn (HR 4928), California Congressman Philip Burton (HR 4929), and Rhode Island Senator John Chafee (S 2105, S 2106).

Each of the bills imposes on public pension plans certain types of standardized reports, actuarial and accounting analyses, and disclosures to participants. The proposals would also apply fiduciary responsibilities to plan trustees, managers, and other cofiduciaries. PERISA would be administered by one or more federal agencies and by federal courts. It would preempt state law with regard to the subject matter affected.

The Board's letter pointed out that PERISA would add greatly to the administrative burdens and expenses of public pension systems. The expense, uncertainties and delays would adversely affect the services which the pension systems give their participants. The ironic result of PERISA would likely be detrimental rather than beneficial for the individual employee.

Public employees in Texas are already protected by pension plan provisions in state law enforceable through administrative and judicial proceedings, by state constitutional provisions which prohibit diversion of funds and require prudent investment as well as sound actuarial funding of benefits, by a law creating a pension review board which requires annual reports and disclosure to members, and by the state's open records law and open meeting law which make the activities of pension fund trustees a matter of public record.

PERISA bills as introduced could threaten pension participants in Texas in the following respects:

1. Open individual member records to public scrutiny.
2. Override present state constitutional protection against imprudent social investing.
3. Increase administrative costs, draining away funds which otherwise would be used to pay benefits.
4. Slow initial payment of claims and benefits by imposing federal regulations on procedures.
5. Discourage valuable unpaid service on the TRS Board of Trustees and Investment Advisory Committee by qualified persons with investment experience because of possible personal expense in defending frivolous lawsuits which are encouraged by the proposed legislation.
6. HB 4929/S 2106 could cause Internal Revenue Service to impose a greater tax liability on death benefits, an income tax on employees for the State contribution (8.5 percent of salary), and a tax on TRS investment earnings, drastically cutting the amounts available for benefits.
7. Sacrifice the interests of individual TRS members and retirees to the special interests of political and economic groups who wish to exercise federal control over all public pension plans.

Board Sets Election For Smith's Position

Dewey G. Smith, superintendent of Alice ISD, has announced his plans to retire from Texas public schools to enter business in the private sector. The Board of Trustees has set a special election to be held between September 1 and October 15, 1982 to nominate three candidates for his public school district position with a term expiring August 31, 1983.

A member currently employed by a public school district may become a candidate by filing an official petition bearing the signatures, printed or typed names, and social security numbers of at least 500 members currently employed by or whose most recent credited service was performed for a public school district. A qualified member may sign more than one candidate's petition.

Petitions, available from TRS, 1001 Trinity, Austin, Texas 78701, must be filed by July 1, 1982 with the Executive Secretary of TRS in order for the candidate's name to be printed on the ballot.

Smith has been a member of the Board since 1975, and was vice chairman from June, 1979 until September, 1980. He will continue to serve until his successor is named by the governor from the three persons nominated in the election.

NEW RATE To Begin Sept. 1 For Service Credit Purchase

The current 5 percent annual rate will be increased beginning September 1, 1982 to 8 percent compounded annually for establishing military duty and out-of-state service and to 6 percent compounded annually for reinstating a withdrawn account and membership terminated by retirement.

Purchase of the credit before the deadline would result in considerable savings for eligible members. The compounding effect will result in the cost of purchase doubling in 9 years at 8 percent and 12 years at 6 percent. At 5 percent simple interest, the cost doubles only after 20 years.

The new rates were established by the legislature with the September 1, 1982 effective date to allow time for members to make necessary payments at the lower 5 percent simple rate.

Members planning purchase should contact TRS now so that a bill can be prepared for them before the deadline.

Texas State Teachers Association House of Delegates has voted to oppose federal legislation that would mandate that TRS come under federal regulation. The State Pension Review Board which has oversight over all public pension plans in Texas and trustees of the four statewide pension systems are all on record as opposing PERISA because it will weaken protection of plan participants.

See related story on back.

Teacher Retirement System of Texas
1001 Trinity St./Austin, Texas 78701

Bulk Rate
U.S. POSTAGE
PAID
Austin, Texas
PERMIT NO. 2603

ADDRESS CORRECTION REQUESTED

Refund Procedures Explained

A delay in receiving a refund is cause for concern for a member who has permanently terminated employment in an eligible position covered by TRS.

A refund is usually made in approximately 30-45 days following receipt of both the member's final deposit and the "Application for Refund" (form TRS 6), according to Joe Click, Refunds department supervisor.

During 1980-81, Click and his staff processed refund requests of $85.5 million for 55,493 members who withdrew from public education employment. This compares with $21.1 million refund to 35,562 members ten years ago. A large percentage is refunded during September and October each year.

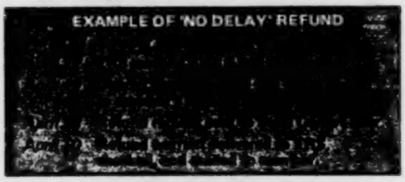
Procedure for Obtaining Refund

- **Member fills out "Application for Refund" (form TRS 6), which can be obtained from TRS or from the school business office. TRS 6 may be completed on or after the date the member's contract terminates.**
- **TRS 6, certified by the school district, is sent to TRS with the district's monthly report containing the final transaction to the member's account. (TRS 6 may be sent directly to TRS if the member has not been employed in a covered position during the current school year.)**
- **After the district report is balanced and final deposit posted to the member's account, the refund request is added to the weekly refund warrant request list which is made to the State Comptroller of Public Accounts.**
- **Usually the State Comptroller furnishes the warrant within two to five days.**
- **The same day the warrant is received by TRS it is checked for accuracy and put into the mail to the member.**

No exceptions can be made to these procedures which have been established by auditors to avoid the possibility of fraud in processing the large amount of money involved.

Possible Causes for Delay

- **The member left employment before the end of a full month, so the last transaction for the member on a district report would be a negative amount shown on the following month's report.**
- **If a member is indebted to the State (non-payment of taxes, delinquent on payment of student loan, etc.), the State Comptroller will hold the warrant until the indebtedness has been satisfied.**
- **Names, addresses, or social security numbers shown on State Comptroller records may not be the same as those on TRS records.**
- **The member has moved and failed to inform TRS of the address change.**
- **District report is late.**



The Member Should Know

- **Interest on active accounts is credited each August 31 and an account withdrawn before August 31 will not receive partial interest for the year.**
- **If the $5 membership fee, usually submitted with the first deposit each year, has not been submitted, it will be deducted from the member's account prior to the refund.**
- **A member with at least ten years of creditable service has a vested right to retirement benefits upon reaching retirement age if deposits are not withdrawn.**

Dramatic Growth Seen In School Population

Dramatic statistics on the projected future growth of education in Texas have been quoted by Texas Education Agency Commissioner Raymon L. Bynum in speeches to groups across the state.

A growth of 50 percent in student population by the year 2000 is predicted by the Governor's Texas 2000 Commission. A 20 percent increase in elementary enrollment in the 80's and a 32 percent increase in secondary level in the 90's are predicted by the commission. From 1980 to 1990 pupil enrollment will grow by 500,000 students, and from 1990 to 2000, enrollment is predicted to increase by an additional million students.

Bynum points out that the state which has grown by 3 million people in the last ten years now has a population of 14 million and is growing at a 27.1 percent rate, more than double the rate for the nation as a whole. From 1970 to 1980, in-migration accounted for over 50 percent of the growth. Expansion and growth of suburbia in Texas is continuing at a rapid pace with the largest rate of population gain.

One of the most startling revelations, according to Bynum, has been the steady decline of the number of students graduating from college and university teacher education programs since 1972. "Unless this trend is reversed and we begin to attract more students into educational careers, we will be facing a devastating teacher shortage within the next few years," he said. "In certain specific areas the shortage is already critical. With 60,000 new secondary students headed for high school within four years, we must immediately begin recruitment and incentive activities to attract and hold the teachers that will be needed to staff these classrooms."

Social Security Number	***Make Necessary Corrections And Return to:*** Teacher Retirement System 1001 Trinity Austin, Texas 78701
Name	
NEW ADDRESS	
DO WE HAVE YOUR CORRECT ADDRESS?	

Private Funds Face Loss Of 'Prudent Man' Protection

A bill redefining "reasonable" rate of return, thus removing the "prudent man" rule, on investments in home mortgages made by private pension funds (S 1678) has been introduced in Congress by Sen. Orrin Hatch (R-Utah).

The bill would amend ERISA which governs private pension plans to allow the private funds to invest in residential mortgages at a rate of return on those investments which would at least equal the average net yield of all investments by the plan for the preceding 10-year period or at the rate of return which is consistent with other rates of return on similar investments, whichever is less.

This bill would apply to ERISA and private pension funds only, but it is an example of the pressures which would be applied to public funds to invest in social issues at a rate below market at the expense of plan participants should PERISA become law. PERISA and future amendments to the law would take precedence over state law and constitutional protections for TRS and other public pension plans, including the prudent man rule in the Texas Constitution.

TRS investments in real estate mortgages, as in all investment transactions, are made at the highest rate of return with safety of capital and sustainable yield over a long period of time of prime importance. When yield and quality considerations are equal, prefer is given to investments within the state.

EXECUTIVE SECRETARY
Bruce Hineman

TRS

Teacher Retirement System of Texas

May 6, 1982

U.S. Senate
Washington, D.C. 20510

Dear Senator

The members of the State Board of Trustees of the Teacher Retirement System of Texas have adopted the enclosed statement opposing the enactment of federal legislation regulating public employee retirement programs (PERISA).

The staff of this agency has undertaken an extensive study of proposed PERISA bills (HR 4928, HR 4929, S 2105, S 2106) as introduced and have projected their impact on the retirement program we administer. It is our conclusion that none of these bills are needed to protect public employees in Texas. This state already has taken significant action to protect public employees' interests with state constitutional provisions and a Pension Review Board which monitors the actions of all state and local public employee plans and advises the State Legislature on pension legislation.

In fact, PERISA's provisions, by preempting state law, may completely destroy the state's constitutional protection of Texas public employee pension interests. This protection is much stronger in many respects than that provided in PERISA bills.

It is the Trustee's intention to communicate further with you and our over 500,000 members concerning the threat to their interests and the unnecessary costs to state government which PERISA poses.

Sincerely,

Bruce Hineman

Bruce Hineman

mav

1001 Trinity Street/Austin, Texas 78701/(512)397-6400

EXECUTIVE SECRETARY
Bruce Hineman

TRS

Teacher Retirement System of Texas

March 30, 1982

To the members of the U.S. House and Senate from the State of Texas:

The trustees of the Teacher Retirement System of Texas are opposed to the enactment by the United States Congress of legislation to regulate public pension plans for state and local government employees. PERISA (Public Employee Retirement Income Security Act) bills have been introduced by Illinois Congressman John Erlenborn (HR 4928), California Congressman Philip Burton (HR 4929), and Rhode Island Senator John Chafee (S 2105, S 2106).

Each of the bills impose on public pension plans certain types of standarized reports, actuarial and accounting analyses, and disclosures to participants. The proposals would also apply fiduciary responsibilities to plan trustees, managers, and other co-fiduciaries similar to those in ERISA. PERISA would be administered by one or more federal agencies and by federal courts. It would preempt state law with regard to the subject matter affected.

We primarily oppose PERISA because it is unnecessary. Studies, including even those which formed the basis for this legislation, have clearly shown that the vast majority of state and local public employees are covered by sound, well-run pension systems operated in the interest of their participants. Public systems which have experienced problems have involved ~~only~~ a small percentage of total public employees. Public pension plans, other than federal plans, are not facing a serious funding crisis. Contrary to the situation in the private sector which led to ERISA, there have been no significant examples of public pension defaults or manipulations against the employees' interests which would be addressed by this proposed federal legislation.

Public plans are already receiving great attention by policymakers at the state and local level from the standpoint of protecting employees' interests from abuses and in securing adequate funding. Furthermore, in light of recent administrative and legislative developments involving ERISA, the Texas state constitutional provisions establishing fiduciary responsibilities for public pension funds probably afford public employees more protection than would PERISA with respect to one of the most critical issue currently facing retirement plans--social investing.

PERISA would add greatly to the administrative burdens and expenses of public pension systems. It would affect all significant pension legislation, rules, and administration at the state and local level. There would be more time wasted in filling out forms; in examining, commenting on, and perhaps litigating proposed federal rules changes; and in implementing policy changes. The expense, uncertainties and delays would adversely affect the services which the pension systems give their participants. The ironic result of PERISA would likely be detrimental rather than beneficial for the individual employee. If, as we believe, comprehensive PERISA legislation is unnecessary, there is no justification for imposing its costs and burdens on the public, its pension agencies, and pension beneficiaries.

We note with approval that developments on the national political scene show a renewed interest in promoting federalism. An obviously essential aspect of federalism is that state governments and their political subdivisions must control their own basic personnel policies. Pension systems are a part of the compensation of public employees. If federalism is to mean anything, the national government must not get as deeply involved in the details of the states' pension policies as PERISA would propose. It is highly probable that such involvement is in fact unconstitutional for the same reasons that the U.S. Supreme Court held provisions of federal law regulating wages and hours of state employees to be unconstitutional in National League of Cities v. Usery. Unquestionably, the constitutionality of PERISA if enacted will be challenged, and this issue can only lead to great confusion while the suit is pending.

There are two striking inconsistencies in the proposed legislation. None of the bills affect either federal pension plans or public retirement plans provided through private carriers, such as the Optional Retirement Program for public employees of Texas colleges and universities. Since federal plans are probably the greatest single offenders against sound pension policy, we have difficulty in accepting the stated rationale for federal regulation of state and local plans. Private carriers providing retirement plans to governmental employees are exempt from ERISA; there can be no satisfactory reason to exempt them from PERISA.

It is our conclusion that PERISA is bad legislation primarily because its stated goals are being acheived more effectively on the state and local level. There is no reason to needlessly encumber public plans with bureaucracy, especially in a form which would probably be declared unconstitutional.

Robert R Ashworth

Roger B. Mize, Chairman
Snyder, Texas

Robert R. Ashworth
Amarillo, Texas

Henry M. Bell, Jr.
Tyler, Texas

Frank Monroe

Sheila Payne

Charles A. Hallmark
Houston, Texas

Frank Monroe
Dallas, Texas

Sheila Payne
Arlington, Texas

CA Roberson

Edward H. Wicker

C. A. Roberson
Fort Worth, Texas

Dewey G. Smith
Alice, Texas

Edward H. Wicker
Beeville, Texas

Bruce Hineman

Bruce Hineman
Executive Secretary

Vol. 3 No. 8

TEACHER RETIREMENT SYSTEM OF TEXAS

UP-DATE May 13, 1982 Bruce Hineman, *Executive Secretary*

Urgent!

PERISA (WITH NAME CHANGE) PASSES COMMITTEE; MAY COME TO HOUSE VOTE NEXT WEEK

The House Education and Labor Committee this week passed a Public Employee Retirement Income Security Act (PERISA), HR 4928 and 4929, virtually as originally written. The name was changed to "Public Employee Pension Plan Reporting and Accountability Act of 1982" (PEPPRAA).

Organizations which have been opposing PERISA are predicting passage of PEPPRAA unless a major lobby effort is launched. Bill sponsors hope to get the bill to the House floor next week.

The bill would:

1. *Override existing state constitutional protections for members and annuitants.*
2. *Increase costs of administering TRS, diverting funds which could otherwise be used for benefit increases.*
3. *Provide a means to allow investment of retirement funds at lower rates for social purposes (e.g. to bail out insolvent governmental units with low cost loans).*
4. *Place federal controls on state and local government employee benefits.*
5. *Open confidential individual accounts to public disclosure.*

TRS members who want to express opposition to federal control should contact their congressmen immediately. Please make every effort to get the word to your employees.

1001 Trinity, Austin, Texas 78701

Vol. 3 No. 9

TEACHER RETIREMENT SYSTEM OF TEXAS
UP-DATE
May 24, 1982
Bruce Hineman, *Executive Secretary*

PEPPRAA (PERISA) OPPOSITION BUILDS

The cards, letters, telegrams, and telephone calls by teachers and other public employees in Texas are making the U. S. congressional delegation from Texas acutely aware of the provisions of Public Employees Pension Plan Reporting and Accountability Act (PEPPRAA, formerly PERISA), the problems it would cause public retirement systems in Texas, and their opposition to it.

Both Senator John Tower and Senator Lloyd Bentsen are opposed to the bills. TRS has received reports that many Representatives are also opposed. Efforts should be continued to inform Washington of the concerns of Texas teachers. If a member receives a commitment from a congressman, TRS would like a copy of it in order to publish in some future issue a list of those opposed.

HR 4928 is now in the House Rules committee and will probably not be scheduled for floor action until after the Memorial Day recess. HR 4929 is in the House Ways and Means committee and chances are good that it will remain there.

SOME REASONS TO BE CONCERNED ABOUT PEPPRAA

The bill would:

1. *Override existing state constitutional protections for members and annuitants.*
2. *Increase costs of administering TRS, diverting funds which could otherwise be used for benefit increases.*
3. *Provide a means to allow investment of retirement funds at lower rates for social purposes (e.g. to bail out insolvent governmental units with low cost loans).*
4. *Place federal controls on state and local government employee benefits.*
5. *Open confidential individual accounts to public disclosure.*

REPORTS, BENEFITS WORKSHOPS PLANNED

A workshop on TRS monthly reports and membership benefits will be conducted in each Education Service Center region between June 22 and July 19. The workshops, designed for those who file monthly reports to TRS and others who may furnish information on TRS benefits to employees, were scheduled at the request of participants in the successful workshops last year.

One session, from 9 a.m. until 12 noon, will be held at each location. The workshops will be located at the Regional Education Service Center except the following: Lubbock, Texas Tech University, Senate Room, Music Center Complex; El Paso, University of Texas at El Paso, Suite 312 E. Union Bldg.; and San Antonio, Northeast San Antonio ISD, Blosums Athletic Center, Starcrest and Jones Maltberger. Contact TRS for addresses and other workshop information.

See workshop schedule on back.

1001 Trinity, Austin, Texas 78701

EXECUTIVE SECRETARY
Bruce Hinchman

LEGAL SERVICES
William Baker, General Counsel

TRS

Teacher Retirement System of Texas

May 24, 1982

xxx
xxx
xxx

Dear Congressman xxx:

Attached is a summary of arguments against legislation to regulate state and local government pension plans from the standpoint of the Teacher Retirement System of Texas. The bills (HR 4928 by Erlenborn, HR 4929 by Philip Burton, S 2105 and S 2106 by Chafee) have been known by the acronym PERISA and the House Committee versions have become PEPPRA.

This legislation would have a pervasive impact on this pension plan and its almost 500,000 participants and annuitants. We object to it on the following grounds, among others:

1. It will reduce the protection already available to participants and beneficiaries under the Texas Constitution and statutes.

2. It will make more possible the social control of Texas public pension investments at the expense of security and income.

3. It will discourage uncompensated service by qualified persons as public pension fund trustees.

4. It will make structural changes in the responsibilities and powers of state pension plan trustees.

5. It will result in the federal courts becoming the primary interpreters of state pension laws.

6. It will impose costs which divert pension funds from their proper use--to pay benefits.

7. It will not automatically exempt state pension plans (such as Texas' statewide plans) from the most objectionable features of the legislation.

1001 Trinity Street, Austin, Texas 78701 (512) 397-6400

8. Some of its actuarial provisions will essentially require distortions of the actual condition of public funds.

9. It will delay administrative decisions on contested claims brought by pension participants.

10. It is not needed.

We will be happy to provide further explanation of our objections.

Yours very truly,

William Baker

WB:bn
Enclosure

Annotated to committee print
of HR 4928, May 10, 1982

Teacher Retirement System of Texas

May 21, 1982

Arguments Against PERISA-PEPPRA

Legislation has been introduced in Congress to regulate state and local government pension plans. The bills (HR 4928 by Erlenborn, HR 4929 by Philip Burton, S 2105 and S 2106 by Chafee) were known by the acronym PERISA when introduced. In the House, after committee amendment they are now known as PEPPRA.

The Trustees of the Teacher Retirement System of Texas oppose this legislation because (1) it is unnecessary, (2) it would actually diminish rather than increase protection for our members and annuitants, and (3) it could impose burdensome procedures and costs on the State of Texas without really providing any benefit. The trustees also oppose the proposed legislation as an unwarranted intrusion of federal regulation in an area properly reserved to the states.

1. Regulation of State and Local Government Pension Plans is Unnecessary.

As a whole state and local pension systems in the nation are in good condition. A 1981 HUD study performed by the Urban Institute shows that the funding position of these plans is good and will improve over time. This finding disputes that of the House Pension Task Force which has served as the basis for much talk about poor funding standards of state and local plans. Even the Task Force study, when examined closely, shows that the great majority of state and local government employees are covered by well operated pension plans.

PERISA-PEPPRA in fact would do little to accomplish reforms in public pension plans even if they were needed. It does not include vesting and funding requirements for plans. Unfunded plans covering highly compensated employees are explicitly excluded from coverage by the act.[1] Instead, the act only creates another layer of bureaucratic regulation which will generate mountains of paper for no justifiable purpose.

Many states have already taken substantial steps to assure well operated state and local government pension systems. For example, Texas has a State Pension Review Board which examines and reports on the funding of all public plans (other than federal) within the state, collects information from these systems, and reviews proposed pension legislation for actuarial and pension policy soundness. Texas law also requires information concerning the pension plan to be regularly and individually provided to public employees. The major Texas plans are well-operated, actuarially sound, and efficiently managed. They have no need for, and in fact would be adversely affected by, the proposed legislation.

Ironically PERISA-PEPPRA omits two areas where significant problems may exist for public pensions. (1) All federal pension plans are excluded from the proposed law[2] despite acknowlegement by some in Congress such as Congressman

Erlenborn that the unfunded liabilities of these funds (not including Social Security) are very great. (2) Many states, including Texas, provide retirement annuities from private insurance companies in lieu of participation in a public plan. These annuity programs, which may serve as the primary retirement income for many public educational employees, are excluded both from ERISA and the proposed PERISA-PEPPRA. Over the years many abuses of the private annuity program have come to the attention of the Teacher Retirement System but are beyond our control. If neither of these areas merit similar regulatory control, there is certainly no reason to extend federal controls to state and local government pension plans.

2. Fiduciary Standards Under PERISA-PEPPRA Threaten Existing State Constitutional and Statutory Protection.

One of the objects of PERISA-PEPPRA has been to impose fiduciary duties upon those having some discretionary authority over pension plan investments or administration. However, at least insofar as Texas is concerned, the result of the enactment of this legislation would be to diminish the protections already afforded plan members and beneficiaries by state law.

Article 16, Section 67 of the Constitution of the State of Texas imposes fiduciary requirements on the investments of public pension plans, makes the trustees responsible for the plan's operation as fiduciaries, forbids diversion of the pension funds, and requires benefits to be, with the exception of the Judicial Retirement System, funded on an actuarially sound basis. PERISA-PEPPRA contains a provision which would largely preempt these protections, especially with respect to investments.[3]

(Another preempted state law would be the Texas Open Records Act which makes individual member pension records confidential. The protection of federal privacy laws and regulations are not as strong as Texas laws for pension records.)[17]

PERISA-PEPPRA contains a fiduciary standard which some have argued to be more restrictive than the traditional prudent person rule. The Texas Constitution requires pension investments to be made with "the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income therefrom as well as the probable safety of their capital." The proposed PERISA-PEPPRA standard is for "the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[4] By replacing "persons of ordinary prudence" with a "prudent person acting in like capacity and familiar with such matters", the proposed legislation seems to impose a higher standard of the expert or experienced pension investor. However, in reality, this may open Texas pension funds to more speculative investments. For example many pension experts now advocate placing a portion of the fund in somewhat risky venture capital investments. The Texas Constitution probably prohibits this; PERISA-PEPPRA probably would not. Under PERISA-PEPPRA public pension managers in Texas could be more exposed to the ever changing theories of portfolio management, subjected to sophisticated arguments that the general benefits of some social investments are in the interest of pension participants, and freed from the explicit mandate to consider safety of capital as well as probable income. The overall fiduciary standard in these bills is for pension fund management to be "in the interest of the participants and beneficiaries"[5] which, when used to interpret the federal prudent person rule, can justify a great many investments prohibited by the Texas Constitution. We seriously question whether the standard of a prudent person in like capacity and familiar with such matters is really as strong a fiduciary standard as it first appears to be.

Federal courts have already softened the fiduciary language in ERISA (almost identical with that in PERISA-PEPPRA). The U.S. Circuit Court of Appeals for the Ninth Circuit ruled in Fentron Industries, Inc. v. The National Shopmen Pension Fund, (Nos. 81-3110 and 81-3330, April 26, 1982) that ERISA's fiduciary standards conform to the standard of care found in the Taft-Hartley Act. Rather than imposing a per se liability, the law finds a violation of a trustee's fiduciary duty only when there is bad faith involved, or if a decision lacked substantial evidentiary support.

A further indication of the flawed fiduciary provisions in PERISA-PEPPRA is the inclusion of explicit requirements or prohibitions which would seem at first glance to be covered by the more general fiduciary language. For example, the prohibited transactions provisions forbid certain transactions for an inappropriate amount of consideration if a party in interest is involved.[6] Does this mean by implication that, where no party in interest is involved, the general fiduciary standards will permit investments for less than adequate consideration? In another example the prudent person rule of the statute is followed by a requirement that investments be diversified.[7] This addition seems to imply that the prudent person rule of PERISA-PEPPRA is really not as comprehensive and strict as it seems to be.

Under PERISA-PEPPRA the Secretary of Labor could adopt rules which would permit financial bailouts of state and local governments in financial trouble. Section 207(b)(6) of HR 4929 as introduced defines the qualifying employer loans which may be made by a pension fund to include loans having an "interest rate which is consistent with the requirements relating to fiduciary functions under Section 204 and which is fully secured by marketable securities, or such other employer loan as defined under regulations issued by the Secretary". (Emphasis added.) This would preempt the provisions of the Texas Constitution which require investment under the prudent man rule and which forbid the diversion of funds for purposes other than retirement and related benefits.

We do not comment on the actions of fund managers of other jurisdictions, but in Texas the use of pension funds to bail out a financially troubled governmental unit is virtually impossible. By authorizing a more permissive federal standard to accomodate these jurisdictions which do permit such bailouts, PERISA-PEPPRA would reduce the protections afforded to the pension benefits of over one million Texans--teachers, state employees, county and city employees, their families and beneficiaries. This points out one of our basic contentions--control over state and local pension plans is best left up to the states under our federal system. Those jurisdictions, e.g. New York City and Detroit, may continue to work with the IRS, as they have done, to fashion acceptable procedures to accomplish such bailouts as they feel are justified. Those jurisdictions which place a high priority on the protection of the employees pension funds, however, should be allowed to retain their own protection.

The preemption of state constitutional protections creates another, even more serious threat to Texas public employees. PERISA-PEPPRA if enacted will be subject to further amendments. Already ERISA amendments are being proposed which permit or require social investing, i.e. investment for social purposes, such as promotion of real estate development, at the expense of safety and/or return. S 1678 by Hatch and S 2467 by DeConcini are examples. We are aware of the quick, unobtrusive manner in which such amendments can be passed in Congress. By contrast the Texas constitutional protections are more secure, requiring a vote of the people to be changed.

We believe Texas teachers to be very aware of the potential threats to their retirement fund. In 1971, then Lt. Governor Ben Barnes succeeded in having legislation passed to delay for a few months state contributions to the Teacher Retirement Fund. This sparked an intense reaction among Texas public educators which contributed in part to Barnes' defeat in 1972 and led to the adoption in 1975 of the current constitutional pension protections enjoyed by Texas public employees. The Board of Trustees of TRS is able to rely upon the easily understood requirements of these provisions to shield the fund from political and economic forces which might operate against the interest of public employees in the state. PERISA-PEPPRA poses a threat to those protections and to sound pension management in the state.

3. Excessive Costs of Federal Regulation.

a. No cost study made.

PERISA-PEPPRA will have costs which outweigh any alleged benefit. The costs of state and local government compliance with its provisions have, to our knowledge, not yet been determined. Much of the cost will undoubtedly vary with the degree of detail required by the Secretary of Labor in future regulations. It seems reasonable for Congress to commission, through the GAO or some similar institution, a study of these costs before acting on the legislation. For example, if the Secretary requires information to be provided to individual participants by mail, this may have a significant cost.[8] Another example of cost is the required detailed compilation of enormous amounts of data for annual reports[9] which is already available under state open records laws to those who are really interested and able to act knowledgeably to protect pension interests. We believe that the act will create substantial costs for pension plans which will needlessly divert pension money from being used to pay benefits.

b. Cost implications of actuarial provisions.

The provisions affecting actuarial reports may have significant cost implications. PERISA-PEPPRA would require an actuarial evaluation of pension assets, including fixed income assets, to be based on market value.[10] (Strangely, even ERISA permits a plan's actuary to evaluate bonds on an amortized cost method but none of the PERISA-PEPPRA versions do so.) The practical result of this requirement may be to overstate pension assets in time of low interest rates and to understate these assets in time of high interest rates. Either distortion can lead to actions by the plan sponsor which has undesireable cost consequences.

In addition, many object to the requirements for breaking down and reporting pension liabilities assuming an immediate plan termination.[11] This is an unrealistic assumption with respect to public plans as a whole. The actuarial work needed to report the assumed liabilities would involve unnecessary costs and, again, distort pension liabilities and possibly mislead those who generally set and implement public pension funding policies.

PERISA-PEPPRA would apparently exempt the State Board of Trustees from liability for funding decisions for benefits and administration.[12] This would override Texas constitutional and statutory provisions which give the Board some responsibility for these decisions. In Texas, The Board of Trustees must approve the actuary's recommended assumptions and must set the assumed rate of return on the fund's investments. We believe this arrangement is far superior to giving the actuary essentially the sole responsibility for evaluating the condition of the plan. Practically speaking, the Board of Trustees is better equipped to go before the state legislature with its estimates of needed funding for benefits and proposed benefits when it has some stake in the projection being made. We are concerned that the actuarial exemptions in PERISA-PEPPRA will weaken the state constitutional requirements for most Texas pension plans to be actuarially funded on a sound basis under the direction of a Board of Trustees. The Board, not an actuary, should ultimately have both the power and the responsibility to effectively represent the needs of pension participants before the legislature.

c. Service by trustees discouraged.

PERISA-PEPPRA will also have other costs more difficult to measure but just as real. Administering the plan in accordance with plan provisions incorporated into state law is one of the trustees' duties.[13] Because the enforcement provisions of the act liberally favor federal litigation,[14] it is quite probable that most controversies involving differences over construction of state pension laws will be taken to federal court with members of the State Board of Trustees named personally as defendents. We believe that many frivolous lawsuits will be filed and that this alone will discourage service by qualified persons as trustees and advisors to the plan. I would point out that over the years the Teacher Retirement System has benefited greatly from the public service by many qualified and experienced persons on its boards and committees for nothing more than their expenses. We believe that passage of this act will cost the participants of this system dearly by discouraging the continued service of these people.

d. Procedural delays.

Another cost to the participants will come from the procedural delays which may be required or encouraged by adding federal regulation to the public pension picture.[15] The use of the federal courts under the proposed legislation will itself probably delay decisions on basic questions of state law which, because of less crowded state dockets, are resolved presently in a matter of months. State courts should be the initial forum for reviewing administration of state pension laws. I would point out that Texas, like many other states, has an administrative practices act which adequately provides for an administrative review of decisions with due process.

4. Unwarranted Federal Intervention in State Affairs.

It is ironic that this type of legislation should be seriously considered at a time when there is a new emphasis on federalism. Pension plans are an essential part of a state or local government's personnel policies. There is no justification for federal intervention into essentially state and local governmental affairs. This bill addresses no pressing crisis. There is no overriding reason for its preemption of state statutory and constitutional provisions, its changes in the state's allocating of actuarial and administrative responsibilities, its effective transfer of the primary responsibility for interpreting state pension law from state courts to the federal courts, and its saddling of additional costs and procedures on state pension participants through its many explicit provisions and the inevitable flood of federal regulations to follow.

5. Texas Not Exempted.

Proponents of PERISA-PEPPRA have erroneously stated that Texas will be "automatically exempted" from the act. First, the exemption contained in the bills would apply primarily to the disclosure and reporting sections of the act and not to the provisions which would preempt the Texas constitutional protection for public retirement funds.[16] Second, since many of the detailed reporting and disclosure requirements of the act would be set in later regulations issued by the Secretary of Labor, there is no way to know if Texas would be exempt even though our disclosure practices are generally superior to those required by the statute. Third, if PERISA-PEPPRA's required disclosures of personal information on participants will be material to the exemption determination, statewide pension systems in Texas would not be exempt.[17] Texas law makes this information confidential and subjects government employers violating the law to criminal penalties. Fourth, the exemption process in the latest version of the legislation is misleading. While the governor of a state can make an initial determination of exemption, the Secretary of Labor is given the ultimate administrative power to decide the issue.

PERISA-PEPPRA on the surface seems motivated by good intentions. However, it poses significant threats to the interests of public pension participants and annuitants and will needlessly complicate the administration of public employee retirement programs by state and local governments. There is no real public or private need for federal legislation in this area. Its principal beneficiaries will not be the public or pension recipients, but will rather be the private interests who stand to profit by its bureaucratic requirements or who may subsequently use it as a framework to obtain access to the assets of public pension systems in this country.

NOTES

1 Sec. 4(b)(2)

2 Sec. 3(a)(9) and (22)

3 Sec. 309 and Sec. 214(b)

4 Sec. 204(a)(2)

5 Sec. 204(a)

6 Sec. 206

7 Sec. 204(a)(3)

8 Sec. 115 and Sec. 303

9 Secs. 104-108

10 Secs. 107(c)(6)(A) and (8)(E) and Sec. 3(b)(4)

11 Sec. 107(c)(8). This has apparently been corrected in House versions.

12 Sec. 214(a)(3) and 107(b)

13 Sec. 204(a)(4) and Sec. 301(a)(1)

14 Secs. 301(a)(2),(b)(1), (d)(1), and (f)(1)

15 Sec. 111(d) (last sentence), Sec. 114 (when coupled with Secretary's powers to issue regulations in Secs. 115 and 303), and Sec. 301

16 Sec. 102(a)

17 The more explicit requirements for public disclosure of confidential information have been dropped from the House Committee versions of PEPPRA, but appear in Sec. 105(4) of the originally introduced version of HR 4929/S 2106 (Sec. 1105(4) of HR 4928/S 2105). However, the apparent requirement in Sec. 111(a) that the information on active participants be disclosed to their beneficiaries remains in the House bills. Further, the possibility remains that the Secretary can by regulation issued pursuant to Secs. 112, 115 or 303 require confidential personal information to be disclosed which would in turn be public information under Sec. 112(a)(3).

18 Sec. 102(a) and (c) of House Committee versions of HR 4928 and HR 4929. S 2106 omits any participation by the state's governor. S 2105 gives a governor power to exempt some provisions from application to the state.

Vote On PEPPRA Expected Soon

Would Allow Foot-In-Door For Federal Regulation Of Public Pensions

Congress is expected to vote soon on HR 4929, the Public Employee Pension Plan Reporting and Accountability Act of 1982 (PEPPRA) which was formerly titled PERISA. Passage of this bill or a companion bill, HR 4928 (S 2105 and S 2106 in the Senate), would be the first step in the direction of federal controls and regulation of state and local public pension plans.

NEWSLETTER

TEACHER RETIREMENT SYSTEM

Austin, Texas June 3, 1982

None of these bills is needed to protect public employees in Texas. In fact PEPPRA's provisions, by preempting state law, may completely destroy the state's constitutional protection of Texas public employee pension interests.

Hundreds of calls and letters to congressmen have generated interest in the bills causing proponents to intensify their efforts to get PEPPRA through congress at an early date. A large number of Texas congressmen have indicated to representatives of TRS that they are opposed to PEPPRA. In some instances, direct contact could not be made or congressmen had not yet had time to study the bill because of the hectic schedule due to the ongoing consideration of the federal budget.

Any person with objections or reservations about this legislation should convey them immediately to President Ronald Reagan, Vice President George Bush, and to U.S. Senators and Representatives from Texas.

PROPONENTS SAY - BUT THE FACTS ARE

The recent volume of complaints from Texas public employees against legislation imposing federal controls on state and local government employee pension plans (HR 4928, 4929; S 2105, 2106) has brought a response from the legislation's proponents. The general reaction is that TRS's analysis of the bill was incorrect. However, TRS has furnished Texas congressmen with material which substantiates the conclusions that the legislation endangers, rather than protects, the interest of public employees. The following is a summary of major arguments by supporters of federal legislation countered by the actual facts which refute them.

PROPONENTS SAY - The proposed federal legislation will not affect benefits.

FACTS - By increasing administrative costs with detailed regulations and making diversion of funds more possible, the legislation could impair future benefit improvements. One of the bill's requirements could delay the effective date of retirement applications causing retiring members to lose one or two months of benefits. By opening administrative handling of claims under state pension laws to federal regulations and review by federal courts, member and beneficiary claims resolution will be delayed. Existing state law provides adequate safeguards and state courts are less costly and have fewer delays. (Note that almost all litigation contesting TRS interpretation of state pension law involves a disagreement between at least two outside parties, the member and a spouse or two or more potential beneficiaries.)

PROPONENTS SAY - Texas would be exempt from the legislation because of the good condition of its pension systems.

FACTS - The proposed legislation would not exempt Texas from its fiduciary provisions. It is these provisions which override the state constitutional protection of pension funds enjoyed by Texas public employees. The U.S. Secretary of Labor can veto an exemption of Texas from federal reporting and disclosure requirements.

PROPONENTS SAY - There is a need for federal regulation of state and local government pension plans.

FACTS - Even federal studies show that the great majority of state and local public employees are covered by sound pension systems. The problems which exist are largely local problems involving few employees which can be solved by local and state governments. Public employees have enough political power to cause pension abuses to be corrected if they so desire. There is no nationwide crisis facing state and local pension plans.

PROPONENTS SAY - State and local protections of pension participants are not affected.

FACTS - This is clearly incorrect. Article 16, Section 67 of the Texas Constitution imposes fiduciary requirements on public pension plan investments, makes trustees responsible for the plan's operation as fiduciaries, forbids diversion of pension funds to other purposes, and requires benefits to be funded on an actuarially sound basis. Section 309 of the proposed legislation states that the federal regulatory law relating to fiduciary duties would supersede all state laws relating to the same subject matter. Section 214 (b) (3) of the proposed legislation also takes away the fiduciary responsibility of a Texas pension system's Board of Trustees to see, to the best of its ability, that actuarial funding for benefits is provided and that budgeting for the administration of the program is adequate. The provisions of the Texas Constitution protecting pension participants is thus largely superseded by federal law provisions which are in some critical aspects weaker than Texas law.

PROPONENTS SAY - The proposed legislation protects pension plan participants from bad investments by pension trustees.

FACTS - Sections 207 (b) (6) and 208 (a) of the proposed law permits the U.S. Secretary of Labor to issue regulations and to grant exceptions which would permit public pension funds to be used to bail out financially troubled state and local governments (note that this has already been done with federal approval in the cases of Detroit and New York City.) Present Texas constitutional provisions prohibit this but would be overriden by the proposed federal legislation. The federal standards permit more speculative, and therefore more risky, types of investments than does the Texas Constitution. By instituting a framework for federal regulation, this proposed legislation would make it easier for the U.S. Congress to quietly enact future amendments which permit or require pension funds to be invested, at the expense of pension participants, in financially depressed industries at a lower return or greater risk than would otherwise be done. Already there are such amendments introduced for the law regulating private pensions (ERISA). TRS's experience indicates that amending a federal law to remove pension protections without the knowledge of pension participants is relatively easy. (The government pension offset to social security benefits is a recent example.) On the other hand, current state constitutional protections for pension participants cannot be amended without a direct vote of the people. TRS believes the state protections are more reliable.

(Continued on Back)

Texas Legislature Denounces Federal Pension Controls

The 67th Legislature, Second Called Session, declared its opposition to PERISA in a senate concurrent resolution sponsored by Sen. Kent Caperton of Bryan, Rep. Bill Blythe of Houston and Rep. Bill Clark of Tyler.

Among the reasons listed for opposition to PERISA were: The State Pension Review Board already supervises the state's public pension plans insuring their actuarial soundness and prudent investments. Texas law already provides for disclosure by these pension plans to their participants and annuitants and for reports by these plans to the State Pension Review Board. Article XVI, Section 67 of the Constitution of Texas protects the interests of participants and annuitants of public pension plans by requiring that pension investments be made prudently by pension trustees considering both probable income and safety of capital, by requiring that such funds be held in trust for pension participants and annuitants, by prohibiting diversion of the fund for other purposes, and by requiring the benefits be funded on an actuarially sound basis.

Also, Texas statewide public pension plans are in sound actuarial condition. The Texas Open Records Act makes information maintained by public pension plans, other than information in individual member files, available to the public as well as to any government entity who wishes to investigate the conduct of their affairs

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Federal Pension Plans Placing Severe Strain On Taxpayers

Unaudited data concerning the financial condition of federal pension plans recently made public illustrates the huge deficits and desperate condition of federal plans. A few of the federal plans are shown below in comparison to TRS, one of the best funded teacher retirement systems in the nation. The unfunded actuarial liability per active participant shown in the chart represents that portion of the benefits payable in the future for present active members that exceeds the volume of current assets. Retired members of TRS are reminded that their annuities are fully funded upon their retirement. Read comments by Rep. Larry E. Craig, below, concerning the federal government's ability to regulate pension funds for federal employees.

FEDERAL PENSION FACTS (1980 PLAN YEAR)

	Active	Retired, Survivors, Deferred Vested	Assets (millions)	Present Value of Accrued Benefits Less Assets (millions)	Unfunded Actuarial Liability (millions)	Unfunded Actuarial Liability per Active Participant
Civil Service	2,700,000	1,929,000	$72,980	$357,300	$469,500	$173,889
Military	2,888,000	1,332,000	-0-*	348,900	431,100	149,273
Foreign Service	9,401	7,153	673	3,692	4,990	530,795
Federal Reserve Board and Bank (2 plans)	26,035	9,571	850	171	340	13,041
Teacher Retirement System of Texas	389,735	81,267	6,386	N/A	3,300	8,468

*Military Retirement is a non-contributory pay as you go plan.

Excerpts from the

DISSENTING VIEWS OF HON. LARRY E. CRAIG

Idaho, Member Committee on Education and Labor

It is not my intention to discredit the goals of this proposed legislation, which are laudable. Instead, I believe that the bills are fundamentally unnecessary, inappropriate and counterproductive. In addition the federal record in managing its own pension systems has been less than satisfactory.

THE FEDERAL RECORD As Congressman Erlenborn points out, the unfunded liability of the federal pension systems exceeds $1,000,000,000,000. That liability exceeds the national debt and is growing at a faster rate. Most federal pension-plans are funded on a "pay as you go" basis which is cited by pension experts as not acceptable.

COUNTERPRODUCTIVE There is a real danger in passing this legislation believing that it will solve the basic problems of some of the public pension plans. It would be a comfortable illusion to think that these federal reporting, disclosure and fiduciary standards will cause state and local governments to move any faster than they are now doing to reform their own systems.

A second real danger is that state and local governments, the taxpayers and the participants will be lulled into a false sense of security that the federal government is protecting and guaranteeing public pension benefits. This is simply not the case. A related negative reaction is the assumption that the federal government stands behind public pension benefits. We do not need to send the message that a state and local government can come to the federal government for a bail-out if it mismanages or misplans its pension programs. The message should be clear that state and local governments themselves are ultimately responsible for the pension benefits of their employees. There will be no Uncle Sam with an open checkbook waiting in the wings to bail them out.

The government would be flooded with a barrage of additional reports, documents and surveys which would require more federal staff, costs, and bureaucracy systems. I understand that very few of the ERISA reports are ever used. **Once these federal regulators take over, there will surely be additional burdens, regulations and requirements which go well beyond the relatively limited requirements of this legislation.**

UNNECESSARY To date there have been no defaults in state and local pension benefits due or promised to participants. No public employee has ever lost benefits due to him or her. The few local plans which have run into problems have been reformed or absorbed by the state governments. There is not a current danger of public pension fund defaults like there have been in private plans prior to the passage of ERISA. In fact, state and local plans are on a much sounder basis than are federal systems. Do we need to impose complex ERISA-type requirements on state and local governments when the ERISA system is overburdened and in need of major reforms itself?

All of the major national organizations which represent state and local government are unanimously and strongly opposed to this legislation. A list of these major organizations includes:

The National Governors Association
The National Conference of State Legislators
The National Association of Counties
The National League of Cities
The Municipal Finance Officers Association
The United States Conference of Mayors
The Council of State Governments
The National Association of Towns and Townships

Whether you call it PERISA or PEPPRA, the fact remains—the federal government should not be in the position of regulating and guaranteeing the basic state and local government responsibility—provision of pension benefits for its own employees.

THE FACTS...

(Continued from Front)

PROPONENTS SAY - The bill would not require disclosure of confidential information in individual accounts.

FACTS - House versions have been amended to remove an explicit requirement for such disclosure. However, the U.S. Secretary of Labor's broad authority in the latest proposed House version could still be used to require such information. Further a member's designated beneficiary can get confidential information from a member's file. The Senate versions still require public disclosures of confidential information.

PROPONENTS SAY - The bill would remove Federal Internal Revenue regulation of pension plans through its qualification provisions for favorable tax treatment.

FACTS - The bill which most proponents concede will be considered (HR 4929 by Burton) contains no such provisions. The bill which contains these provisions is in a House Committee (HR 4928 by Erlenborn) and is not likely to be voted on. For the past 13 years, the Teacher Retirement System of Texas has had no problems in having its plan provisions receive formal written approval from the U.S. Internal Revenue Service for qualification under present law. This subject is somewhat complicated; however, it is TRS's opinion that passage of any of the currently proposed federal legislation regulating public pension plans will make qualification for favorable tax treatment of TRS benefits less certain. This conclusion is exactly opposite the claim made by some of the bill's proponents.

PROPONENTS SAY - It is not the intent of proponents that this legislation should harm pension participants.

FACTS - This is small comfort if the result of the legislation will in fact be to cause such harm. Well-intended but poorly conceived bills have been passed by the U.S. Congress which have later been used by special interests to accomplish the very opposite of what the bill's original supporters intended. For that reason, TRS feels that Texas public pension participants are better off relying upon the system of protections already in place under state law. TRS sees too many opportunities in this legislation for using federal controls against the real interests of pension participants. In fact, it will be easier for special interests to gain access to these funds under a general federal law framework than if they have to go from state to state.

Just A Reminder...

- **July 1 is the deadline for petitions to place name on trustee election ballot.**
- **Fees for purchase of special service will increase September 1, 1982.**
- **Consecutive service required after a retired member returns to active service before re-retirement is allowed, is reduced from five to two years, effective September 1, 1982.**

EXECUTIVE SECRETARY
Bruce Hineman

LEGAL SERVICES
William Baker, General Counsel

TRS

Teacher Retirement System of Texas

June 10, 1982

xxx
xxx
xxx
xxx

Re: PEPPRA (HR 4928 and HR 4929)

Dear XXX:

The Teacher Retirement System of Texas is receiving some feedback challenging its analysis of the effects of proposed federal legislation governing state and local government pension plans. TRS continues to stand by its initial analysis and, as its staff continues to examine in detail the proposed bills, is finding even more problems. Enclosed is a response to some of the erroneous claims being made by proponents of this legislation.

Your office has already received from TRS an eleven page analysis dated May 21, 1982 outlining many objectionable aspects of this proposed legislation with specific citations to the provisions of the bills. An examination of the House committee changes has led to a conclusion (1) that, insofar as only the House versions are concerned, the bill no longer requires actuarial valuations of benefits based on the unrealistic assumption of plan termination (see page 8 and note 11 of the May 21 analysis) and (2) that the requirements for disclosure of confidential personal information have been greatly modified but still are unacceptable (see note 17 of the May 21 analysis).

TRS has also received some requests for elaboration on the devices in the bills which would permit use of Texas public pension funds for bailouts of financially troubled governments.

Section 207 of HR 4929 purports to limit the amount of a public retirement fund placed in "employer" securities, loans and real property. Section 3(a)(9) defines the term employer to be a state, its political subdivisions, and their agencies and instrumentalities. Section 207 requires that investments in employer securities and loans be qualified and, when combined with other employer securities, loans and real property, not exceed 5 percent of the fair market value of the assets of the plan. A "qualifying employer loan" is defined by section 207(b)(6) as "an employer loan which bears a rate of interest which is consistent with the requirements relating to fiduciary functions under section

204 and which is fully secured by marketable securities, or such other employer loan as defined under regulations issued by the Secretary." (Emphasis added.)

This provision is highly objectionable to the trustees of this system because it permits the Secretary of Labor to override through section 309(a) the fiduciary provisions of Article XVI, Section 67 of the Texas Constitution with a regulation which is not even required to meet the fiduciary standards in section 204 of the proposed federal law. The word "or" clearly indicates that an employer loan as defined by the Secretary need not meet the section 204 standards.

You should also note that the 5% limit on employer loans is based on market value, not the amount of money invested at cost. Therefore, a pension system could over time invest cumulatively much more than five percent of its assets in employer loans and securities. As recent history suggests, the pressure for using retirement funds to bail out financially troubled governments will be greatest when the credit risk of the loans is greatest and their market value is declining. More and more pension money could be committed to the loans as their aggregate market value continues to shrink below the 5% figure. Our investment staff has described this possibility as investing in a "bucket with a hole in it". Under the critical conditions which will likely surround investments in employer loans, the 5% of market value limitation can easily become a cruel hoax on the pension system's members.

Such investing would not be prudent under the Texas Constitution and probably would not meet the general fiduciary standard of section 204 of PEPPRA. However, section 309(a) of HR 4929 provides that the fiduciary provisions of PEPPRA "supercede" the Texas constitutional protections, and the provisions of section 207(b)(6) modify the fiduciary standards of section 204 with respect to employer loans which the Secretary of Labor might approve in the alternative regulations authorized.

In addition, the provisions of section 208(a) of PEPPRA permitting the Secretary of Labor to grant exemptions from the restrictions of section 206 could provide an alternative method to obtain public employees' pension funds for bailing out financially troubled state and local governments. Section 206(a)(2) prohibits the "lending of money or other extension of credit from the plan to a party in interest without the receipt of adequate security and a rate of interest which is consistent with the requirements relating to fiduciary functions under section 204,..." (A party in interest is defined by section 3(a)(18) (A)(iii) to include an employer, i.e. state government, political subdivision, or their agencies.) Section 208(a) permits the Secretary of Labor to grant an exception to this prohibition. The only logical conclusion is that the Secretary of Labor can permit investment in loans to governments in financial trouble even if these loans do not have adequate security and do not provide a prudent rate of return. While it is true that the Secretary must find that the loans meet certain criteria when granting the exemption, it must be concluded that these criteria are less rigorous than the fiduciary standards in Section 204; otherwise, there would be no reason to provide the exemption in the first place.

This legislation contains loopholes which could easily result in social investment of pension funds at the expense of participants--the very opposite effect from that which its proponents claim. The question facing Congress is whether there is any real justification for reducing the pension protections of the Texas public employee under state law and to impairing the administration of these plans with federal regulation. This office is continuing to study this very complex legislation and will report to you any additional problems posed by it for our members.

Sincerely yours,

William Baker

bn
Enclosure

Why Public Employees and Teachers In Texas Oppose Federal Regulation of Public Pension Plans

The attempt to force federal regulation on state and local governments' pension and retirement plans has too often ignored realities. The Teacher Retirement System of Texas has attempted to focus attention on them. We believe that the interests of public pension plan participants will best be served by the defeat of PEPPRA and any subsequent offspring. We cannot understand how, once confronted by the facts, that groups representing these participants can support such legislation.

Federal regulation of public plans is not needed. The problems which afflict some public plans are relatively rare and can be addressed at the local and state level. The political realities are that federal regulation will inevitably lower the pension funding and investment standards for most participants to a level acceptable in a few politically influential jurisdictions. Such a debasement of pension protection is unacceptable.

Behind all the reports, news releases, bill filings, and propaganda surrounding PEPPRA lie two significant facts: (1) public pension systems have increasingly large amounts of money, and (2) many interests for political, social or economic reasons, want to centralize control over how that money is invested. Often these interests' prime concern is not the return received by pension plans but rather the use to which the money is put. Such centralized control would not be healthy for the nation as a whole and certainly not for the individual pension participants and beneficiaries whose hopes for their old age are tied up in these funds.

The specific provisions of PEPPRA itself, developments in the public pension field and with ERISA, and the political forces maneuvering for future federal legislation affecting pension funds lead us to conclude that PEPPRA is the first step in a struggle for control of public pension fund money for social purposes, at the eventual expense of the plan participants. We urge all those who represent these participants to step back and take a look at this reality. It would not be the first time that a wolf has paraded about in sheep's clothing.

PEPPRA - PERISA Proponen

The volume of complaints from Texas public employees against legislation imposing federal controls on state and local government employee pension plans (HR 4928, 4929; S 2105, 2106) has brought a response from the legislation's proponents. The general reaction is that TRS's analysis of the bill was incorrect. However,-TRS has furnished Texas congressmen with material which substantiates the conclusions that the legislation endangers, rather than protects, the interest of public employees. The following is a summary of major arguments by supporters of federal legislation countered by the actual facts which refute them.

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's Say ------ But the Facts Are

	quire pension funds to be invested, at the expense of pension participants, in financially depressed industries at a lower return or greater risk than would otherwise be done. Already there are such amendments introduced for the law regulating private pensions (ERISA). TRS's experience indicates that amending a federal law to remove pension protections without the knowledge of pension participants is relatively easy. (The government pension offset to social security benefits is a recent example.) On the other hand, current state constitutional protections for pension participants cannot be amended without a direct vote of the people. TRS believes the state protections are more reliable.
PROPONENTS SAY - The bill would encourage better public pension funding and administration.	FACTS - Nothing in PEPPRA requires sound funding of public plans. Disclosure of pension funding is generally available to most interested public plan members and would be even more easily accessible if employee groups and other interested parties would pursue existing political and legal channels, e.g. obtaining state legislation or using state open records laws. PEPPRA would in fact adversely affect funding and administration of public plans with its additional administrative costs, its promotion of the use of unnecessary but expensive services, e.g. insurance for fiduciaries, specialized legal counsel, and its unrealistic approach to the evaluation of bond portfolios. Further its subjecting of public pension trustees to frivolous personal lawsuits in the federal courts concerning the interpretation of the benefit provisions of state law will discourage the uncompensated service by highly qualified, experienced persons from the private sector. Many public plans rely significantly upon such service. By focusing attention almost exclusively on plan trustees, PEPPRA ignores the source of the greatest threat to sound pension funding for public pension plans, which, perhaps contrary to the experience with private plans, come from political forces outside the plans. Section 214 of PEPPRA explicitly provides and legitimizes the method by which social investment and other unwise public pension policies can be forced on pension participants and plan trustees without recourse.
PROPONENTS SAY - The bill would not require disclosure of confidential information in individual accounts.	FACTS - House versions have been amended to remove an explicit requirement for such disclosure. However, the U.S. Secretary of Labor's broad authority in the latest proposed House version could still be used to require such information. Further a member's designated beneficiary can get confidential information from a member's file. The Senate versions still require public disclosures of confidential information.
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PROPONENTS SAY - It is not the intent of proponents that this legislation should harm pension participants.	FACTS - This is small comfort if the result of the legislation will in fact be to cause such harm. Well-intended but poorly conceived bills have been passed by the U.S. Congress which have later been used by special interests to accomplish the very opposite of what the bill's original supporters intended. For that reason, TRS feels that Texas public pension participants are better off relying upon the system of protections already in place under state law. TRS sees too many opportunities in this legislation for using federal controls against the real interests of pension participants. In fact, it will be easier for special interests to gain access to those funds under a general federal law framework than if they have to go from state to state.

Texas takes pension law by the horns

By GAYLE REAVES
American-Statesman Staff

WASHINGTON — Texas government workers and retirees have mounted a war to keep the guardianship of their pension plans out of the hands of Uncle Sam.

Lined up against the federal proposal to regulate public pension systems are directors of the Teacher Retirement System, the Employee Retirement System, members of the Texas State Teachers Association and the Texas Public Employees. Austin, Houston and other Texas cities are opposing it.

In Washington, House Subcommittee on Labor-Management Relations staffers say they can't understand why Texas workers and retirees are so vehemently opposed to a bill designed to protect their interests — or why the opposition is coming almost exclusively from Texas.

The Public Employee Pension Plan Reporting and Accountability Act is sponsored by Reps. Phil Burton of California and John Erlenborn of Illinois. It would spell out what information must be made available to the public about investments and financial standing, how the information is to be reported and establish safeguards to ensure that pension fund officials do their jobs honestly and capably.

The bill has been passed by the House Committee on Education and Labor but won't make it to the House floor until well after the federal budget debate has been finished. An accompanying bill is stuck in the Ways and Means Committee. Similar bills are still in committee in the Senate. The legislation reportedly has strong bipartisan support in both houses.

Texas pension officials say state laws and the Texas Constitution already provide more than adequate reporting and disclosure requirements and safeguards. Rather than adding to those protections, they say, federal regulation would weaken them and the red tape of federal regulation would slow down and decrease the payment of pension benefits.

The flood of protests from retirees and current teachers and state workers has persuaded a majority of the Texas congressional delegation to oppose the bill — including Democrat Jake Pickle of Austin, who says that, as far as Texas is concerned, federal regulation isn't needed. Both U.S. senators from Texas oppose the bill, and the Legislature also passed a resolution against the bill during its special session.

"The opposition to this in Texas is overwhelming. We have had umpteen jillion calls about it," said a Pickle staff member. "We tried to find someone supporting it in Texas to talk to, and we couldn't. NEA (the National Education Association) may favor it, but the TSTA (Texas State Teachers Association, an NEA affiliate) is very much against it."

Arrayed against the worried Texans are some formidable foes. The American Federation of State, County and Municipal Employees, the National Retired Teachers Association, the NEA and the American Federation of Teachers "have worked long and hard for enactment of the PEPPRA bill," the federation's international president, Gerald McEntee, wrote to Bruce Hineman, executive director of the Teacher Retirement System of Texas.

One of the Texas groups' big objections to the bill is that it would allow the "social investing" of pension fund money. They're afraid that if a state or city ran critically short of money, political pressure might be brought to bear to force use of the multimillion-dollar pension funds to bail out the government with low-interest loans.

Supporters of the act say that would not be possible because the bill provides that investments must be made for the sole benefit of the pension system members — not to benefit the state in general. But Texas critics say the bill includes a clause that could allow the secretary of labor to make exceptions that would permit such investments to be forced on a pension fund.

PRELIMINARY REPORT OF NATIONAL COUNCIL ON TEACHER RETIREMENT ON STATE LAW CONFORMANCE WITH PEPPRA

November 15, 1983

The National Council on Teacher Retirement (NCTR) is a membership organization of 44 states and 15 local retirement systems, some of which serve teachers exclusively, others of which include other state and local employee groups. The total assets of NCTR's 44 state systems are roughly $120 billion and the plans include over five million active participants.

Because of the Congress' consideration of H.R. 4929, the Public Employee Pension Plan Reporting and Accountability Act (PEPPRA) in 1982 and its ongoing concern with the need for additional federal disclosure, reporting or fiduciary standards for public plans, NCTR recently conducted a survey of all of its members to obtain current and reliable information regarding state laws and regulations governing public pension plans. This report summarizes NCTR's findings for 12 of the states; similar information for all 50 states is being compiled and will be released in the next few months in a more detailed and comprehensive report. The twelve states included here are: California, Florida, Illinois, Michigan, Minnesota, Missouri, New Jersey, New York, Ohio, Pennsylvania, Texas and Utah.

It is NCTR's conclusion that the current level of state regulation of public pension plans -- as well as the actual performance of most of these funds -- makes federal regulation unnecessary. PEPPRA is a solution in search of a problem. And, at that, it's a poor solution. Its provisions, modeled on ERISA, are designed with private pension plans in mind. For the most part, they reflect a serious lack of knowledge of how public plans operate and how they are currently regulated. The information that we have collected demonstrates that in all three areas covered by PEPPRA, reporting, disclosure and fiduciary standards, almost all of the state laws equal or exceed the requirements of the proposed federal law. Further, those states that have less rigorous laws have pension reform legislation pending or have established legislative study commissions to design a blueprint for regulation of their public pension plans. In fact, in the past two to three years, and even more so in the past five years since the Task Force report that led to PEPPRA was published, the state legislatures have engaged in a prodigious amount of activity in the pension area. If Congress is willing to look at what is actually occurring in the states in regard to the governance of public pension funds, it will learn that there is no vacuum or unaddressed need requiring federal guidance.

The NCTR survey shows the following: state teacher retirement plans, like all state and local retirement systems, are created by state law. In some states, they are created by provisions in the state constitution. State statutes are, in effect, "the plan." The trustees and employees of these pension funds, although they are sometimes classified as quasi-independent entities, are subject to all the laws and regulations that govern the conduct of public officials in the state. In addition, virtually all twelve of the systems reviewed here, like the other teacher plans, are subject to multiple layers of vigorous supervision.

Thus, all twelve plans are reviewed annually by the state auditor or an independent auditor (for the most part, major national firms); some are subject to a two-level review by both a private independent auditor and the state auditor. All twelve are also reviewed, generally on an annual basis, by an independent actuary and ten are monitored by a state level pension review commission, which is responsible for reviewing the overall performance of the fund, including the actuarial valuation.*/ In addition to this heavy degree of supervision, the state legislatures, as a whole, play an active role in overseeing public pension plan performance. In terms of supervision or oversight, there is literally no need for an additional, federal layer.

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*/ These ten commissions are: the California Joint Legislative Retirement Committee, the Illinois Pension Laws Committee, the Michigan Retirement Commission (created but not yet funded), the Minnesota Legislative Committee on Pensions and Retirement, the Missouri Joint Committee on Public Employee Retirement, the New York Permanent Commission on Public Employee Pension and Retirement Systems, the Ohio Retirement Study Commission, the Pennsylvania Public Employee Retirement Study Commission, the Texas State Pension Review Board and the Utah Retirement Subcommittee. Florida and New Jersey currently have under consideration the creation of Joint Legislative Pension Commissions.

The state code and constitutional provisions that establish the retirement systems include detailed requirements for their operations. Besides the specific code sections dealing with teacher retirement plans (and those dealing with other public employee retirement plans where the two are separate), all of the state retirement systems are subject to a broad range of other code provisions. These include: government in the sunshine or open records laws that require that retirement board proceedings and records be made available to the public;*/ state freedom of information laws which insure access to board records in a slightly different fashion;**/ state administrative procedure laws that require retirement boards, like other governmental and quasi-governmental entities to promulgate regulations in a prescribed fashion and to otherwise adhere to procedural safeguards; and state codes of ethics or conflict of interest laws that prohibit executive branch employees -- including the employees of boards and commissions -- from engaging in self-dealing.[*/]

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*/ In all twelve states, the records of the board are open to the public, with the exception of member records and/or Investment Committee deliberations. Most are required to have open meetings as well.

**/ These laws apply not only to the retirement systems themselves, but also to the bodies to which they report -- the state auditor or controller, the pension commission, the insurance department, etc.

These laws, taken together, far exceed the reporting and disclosure provisions of H.R. 4929 and show how unnecessary and inappropriate those provisions are. The H.R. 4929 reporting and disclosure provisions "clone" ERISA and, for that reason, although they may be appropriate for private benefit plans, they simply don't make sense when applied to public plans.

In terms of specific reporting and disclosure requirements, all twelve of the teacher retirement systems reviewed here publish summary plan descriptions (SPD) that are updated on a current basis; all of them meet or exceed the H.R. 4929 standards for an SPD, except for those standards that apply primarily in a private plan context. All twelve of the systems -- or the state agencies that are responsible for their investment decisions -- also publish annual reports that meet the relevant H.R. 4929 requirements. Beyond these documents, all twelve systems issue additional publications and provide additional services, including employer seminars and member consultations, designed to help their members better understand the systems. The larger plans, such as New

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[*/] In many of the states surveyed here, the trustees and/or employees who make investment decisions are required to file financial disclosure statements. All trustees are, of course, subject to state criminal codes.

York, Ohio, Florida, Pennsylvania, California and Utah have field staff that are constantly on the road and/or operate field offices around the state. Needless to say, the state laws and regulations that constitute the plans and regulate their operations are available throughout the states -- in public libraries and major school systems (unlike the enabling documents for private plans).*/

As noted above, PEPPRA includes a number of reporting and disclosure requirements that are appropriate only for private benefit plans. For example, among the items required for a public plan SPD are: the name of the designated agent for service of legal process, a description of the relevant provisions of any applicable collective bargaining agreement, and the procedures for appealing denials of benefits. Nine of the states report that they do not name a designated agent for the simple fact that under state law, the administrator of the plan is the agent; he can be identified by calling the plan's offices or by looking at its annual report. All ten of the states indicated that they do not describe applicable collective bargaining agreements because there are none. Many of the states prohibit the negotiation of pension benefits and the others could not possibly report the information because they administer a statewide plan for numerous employers

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*/ Major plans such as Texas, New York, Pennsylvania and Ohio publish separate booklets that include all of the relevant state laws. California includes the relevant code sections in its annual report.

(almost 850 in the case of New York) each of which negotiates its own agreement(s) with employee groups. Similarly, in regard to appeals from benefit denials, the common practice is to specify those procedures in the letter of denial itself; in some cases this is required by state law.

Similarly, in regard to annual report requirements, many of the items specified in PEPPRA are also not relevant to public plans. Although these vary by state, the most frequently mentioned irrelevant items were: a description of agreements with persons who are "parties in interest", a description of the method by which the plan will be terminated, and schedules of loans or leases in default. The reason these are irrelevant are: agreements with "parties in interest" are prohibited by state law; there are no plans for termination because termination is either prohibited by or not contemplated by state law; and the teacher retirement plans simply don't have loans or leases in default of any magnitude. Many plans are prohibited from owning real estate. In short, these provisions, like the SPD provisions don't relate to the real world of public pension plans.

As noted above, the twelve states included in this survey provide the full range of information required by the PEPPRA SPD and annual report requirements plus more, although not always in the fashion prescribed by PEPPRA. In addition, all twelve states meet the PEPPRA requirements pertaining to "reporting of participant's benefit rights" and do so, for the most part, in person-to-person consultations with members as well as in annual written statements.

This leaves open the question of the extent to which the teacher retirement systems meet the fiduciary standards of the proposed legislation. These standards, like most of the other provisions of PEPPRA, are modeled on ERISA and, for that reason, assume conditions that are typical of private benefit plan operations. This assumption, as discussed above, is misplaced. The context in which state retirement plans operate is totally different from that in which private plans operate. Not only are all the records and proceedings of public plans open to the public, but they are required by law to publish a variety of detailed reports divulging virtually all of the systems' operating characteristics; they are also subject to multiple, often duplicative, layers of supervision. There is virtually nothing that an interested party cannot learn about the operations of a state pension plan.

It is against this background that the fiduciary standards governing the plans' investments must be viewed. Looking at the twelve states covered in this report, at least four have the same fiduciary standard and the same definition of prohibited transactions as do PEPPRA and ERISA. These states are California, Illinois, Ohio and Utah. Of the remaining eight, Pennsylvania imposes the same standard of care as does PEPPRA but instead of requiring diversification of investments, specifies the kinds of investments that are permissible. Michigan also imposes the PEPPRA standard of care, requires diversification of investments (as well as some additional requirements unique to the state), and limits the kinds and amounts of investments that can be made. Pennsylvania and Michigan both prohibit self-dealing, although not in the PEPPRA prohibited transactions language.

Texas and Minnesota each have the same standard of care that differs only slightly from the PEPPRA standard and provides a similar level of protection. Texas is unique in that the investment standard appears in the state constitution, along with other provisions that impose performance standards on the trustees of public pension funds in that state. The Texas-Minnesota investment standard is a prudent person standard, that differs from PEPPRA only in that it does not specify that the care to be exercised must be that of a person "familiar with such matters."[*/] Both states also proscribe self-dealing and Minnesota, in addition, specifies the range of permissible investments (80% of the fund's assets must be placed in specified conventional investments; the remainder can be placed in more speculative investments).

[*/] The Texas and Minnesota standard specifies that the investment fiduciary must exercise "the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable safety of their capital as well as the probable income to be derived therefrom." This standard appears in many state codes.

Of the remaining four states, one, New Jersey, has a statutory standard of care that is similar to the Texas-Minnesota standard. New Jersey also specifies permissible investments and limits the level of investment permissible in any one category. Two states, Florida and Missouri, do not define a prudent person standard (whether the PEPPRA or Texas-Minnesota version), but instead rely on the definition of trustees to impose fiduciary standards on their plan investors. Florida, for example, specifies that the Department of Administration (the investing arm for state retirement funds) holds the funds "in trust" and the director "shall discharge his duties . . . solely in the interest of the participants and beneficiaries for the exclusive purpose of providing benefits to the participants and their beneficiaries and defraying reasonable expenses of administering the plan." Missouri's pension board members are similarly designated trustee by state law and perform as fiduciaries in accordance with a prudent person standard. The standard is implicit in the definition of trustee and in the general state laws that govern the conduct of public officials. Both Florida and Missouri limit the kinds of investments the teachers' funds can make and Florida has a constitutional provision defining the manner in which public pension benefits must relate to available funding. In New York State, the teacher pension fund trustees are bound to act as "public trustees" and can only make certain kinds of statutorily permitted investments, except in regard to five percent of the fund's investments, where the kinds of investments are not limited but the trustees must meet a prudent person standard. All four states prohibit self-dealing, with New York and Florida being particularly rigorous in defining the types of transactions that are prohibited.

In sum, of the twelve states considered in this report, virtually all, with the possible exception of Missouri, have statutory or constitutional mandates that meet or exceed the PEPPRA fiduciary standards; Missouri's laws are less explicit but are interpreted in a fashion that produces the same result. Without exception, all twelve states exceed PEPPRA's fiduciary standard when their investment standards are assessed in the total context of applicable state laws, including the laws that limit the range of permissible fund investments, the laws that elaborate upon the prudent person standard, the laws that establish the supervisory and reporting requirements for state pension plans, and the government in the sunshine and ethics laws that apply to all state entities.

One final comment on the fiduciary standards: PEPPRA gives the Secretary of Labor unlimited discretion to promulgate rules and regulations which he deems necessary to carry out the provisions of the Act; it also gives him broad discretion to create total or partial exemptions from the statutorily specified prohibited transactions. These provisions, taken together, threaten to undermine the stringent investment standards enacted in all twelve of the states reviewed in this report (as well as the laws of the remaining states). The authorization of a federal override of state statutory provisions in a manner that would reduce the protections provided by those provisions is, in NCTR's view, not only unconstitutional but bad policy.

The twelve states summarized in this report, as well as the remaining thirty-eight states that will be covered in NCTR's final report, are assuming an active role in regulating their state employee retirement funds. During the period since the passage of ERISA, while Congress has been deliberating the question of whether or not to regulate the states, the states have, in fact, regulated themselves. Like many other areas of public life, the states are taking the lead and are exceeding the federal standard in their enactments. This is certainly true in regard to the areas covered by PEPPRA: reporting, disclosure and fiduciary standards for public pension plans.

NCTR urges Congress to redirect its deliberations regarding PEPPRA in two ways: the first is to look at the current facts, rather than basing legislation on data collected in the mid-1970's. The times have changed.

The second is to abandon the ERISA framework and to recognize the differences between private benefit plans and public retirement systems. Public employees shouldn't be given the same protections as private employees because the ERISA concepts simply don't apply. Many of the problems that ERISA addressed, such as the lack of minimum accrual of benefits standards and the unavailability of basic information regarding plan performance and structure, simply don't exist in the public plan arena. And, given the level of reporting that occurs already at the state level, there is no need to add to that burden.*/ Most importantly, to NCTR's knowledge, although Congress is concerned about the funding problems of public plans, and some of these are real, especially at the municipal level, the federal government is not willing to guarantee the performance of public plans, as it did that of private plans through the ERISA termination insurance. In short, Congress wants to impose strings without any benefits.

Proponents of PEPPRA have asked if, in fact, the states are already meeting the standards established by PEPPRA, why not go along with it. That's putting the issue backwards; the real question is why support it? The whole concept of federalism based on Jeffersonian principles is that the national government should perform only those functions that the states cannot properly perform. Where the states have acted, the federal government should not intrude. In this case, the states have acted at least at a level that protects the basic interests of plan participants. Going with PEPPRA is allowing the federal foot to intrude in the doorway of the states' business. Decades of experience with federal expansionism make it clear that once a new area is opened to federal regulation, that regulation is likely to be expanded on a regular basis. Federal intrusion means waste and unnecessary administrative burdens, often, as in the case of PEPPRA, with no compensating benefits. As one observer has put it, the problem with a swollen federal government "ironically enough, has not been what some professed to fear: that it would have too much power and interfere with individual freedoms. Rather, it becomes so unwieldly and unworkable that it interferes mainly with itself; it falls all over its own feet and cannot achieve its own objectives."

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*/ The Employee Benefits Research Institute reports that more than $100 million worth of reports filed by private plans under ERISA go unread at the Departmet of Labor and are inaccessible to independent researchers. There is no need to duplicate that waste in regard to the public plans.

The following pages contain summaries of the extent to which the twelve teacher retirement funds reviewed in this report conform with the PEPPRA reporting, disclosure and fiduciary requirements.

STATE TEACHERS RETIREMENT SYSTEM OF CALIFORNIA (STRSC)

Basic Facts:

- Number of Active Members: 260,349
- Number of Annuitants: 90,966
- Total Assets: $10 billion as of June 1983
- Amount of monthly annuity payroll: $59.8 million

STRSC currently retains Arthur Young & Co. as its independent auditor and Milliman & Robertson, Inc. as its actuary; actuarial valuations are made every two years. In addition, the plan is subject to annual review by the State Controller, who reviews the work of the independent auditor and actuary and, in addition, conducts its own review. STRSC is also subject to oversight by the Joint Legislative Retirement Committee, a permanent legislative commission,[*] that assesses public pension plan performance on a continuous basis. The California legislature takes an active role in regard to STRSC; during the 1981-82 year alone, it considered 35 bills affecting the system.

STRSC's nine-person board (six full members, three ex officio) has recently acquired its own investment officer[*/] (a contract employee) and, in addition, relies on private sector professional investment advice.[**/]

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[*] The responsibilities of the Commission are to: study and review the benefits, actuarial condition, investments and procedures of all the retirement systems covering employees and officers of the state; study trends and developments in the field of retirement; analyze each bill affecting any public employee retirement system and make recommendations and reports to the legislature.

STRSC publishes a summary plan description (SPD) that, on its own, or in conjunction with pamphlets addressed to specific plan provisions, covers all of the items required by H.R. 4929 except for: the name and address of the designated agent for service of process (not relevant), a description of the relevant provisions of a collective bargaining agreement (not relevant), and the procedures to be followed in presenting claims for benefits or for challenging a denial of benefits (available in the state code; further, each denial is accompanied with a statement of the relevant appeal procedures). STRSC continuously modifies the plan description material and makes it available to participants and beneficiaries.

In addition, STRSC publishes a comprehensive annual report that, although it does not include all of the items in the form specified by H.R. 4929, does include much more

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[*/] The board members, as specified by the State Education Code, are: a member of the governing board of a school district, an official of a life insurance company, an officer of a bank or savings and loan institution, and three system members, of which at least two must be classroom teachers, while the third may be a retirant. The ex officio members are: the Superintendent of Public Instruction, the State Controller and the Director of Finance.

[**/] Prior to 1983, the Teachers Retirement System relied on the investment capabilities of the Public Employee Retirement System.

detailed information than that bill would require,[*/] including a full print-out of all STRSC investments. The State Controller also publishes an annual report on the financial condition of STRSC and the other state and local retirement systems.

By state law, all data related to the board's operations are available to the public, except for member records and Investment Committee proceedings; STRSC board meetings are open to the public. STRSC also undertakes a major public information effort that includes: workshops for prospective retirants to guide them in preparing for retirement (including how to complete STRSC forms); seminars for employer groups giving information on STRSC program benefits, current and proposed legislation and financial status; individual consultations (5,800 in 1982), the publication of numerous pamphlets covering the most important subject areas for both active and retired teachers and the publication of a newsletter. STRSC members are mailed statements on their individual benefit status on an annual basis.

[*/] The annual report does not include a statement of material commitments and contingent liabilities (there are none), a description of agreements with persons known to be "parties in interest" (against state law), a general description of any plan provision providing for allocation of assets upon termination (no authorization to terminate) or a list of loans in default at the end of the plan year or classified as uncollectible (there are none). The 1982 annual report contained 212 pages of useful information regarding the authorizing laws, structure, operation, investments, funding, etc. of the plan. It also included the SPD.

In terms of investment policy, STRSC specifies permissible investments, which are generally those permitted state savings and loan institutions; and, in addition, imposes requirements for diversification in investment (investments in common stock may not exceed certain levels, nor may investments in individual companies, etc.). The California Code uses language identical to the H.R. 4929 language to define the fiduciary standard that governs board investment decisions and prohibits the same insider transactions.[*/] California also prohibits any acquisition on behalf of the plan of any employer security or loan (H.R. 4929 would permit such acquisitions if they meet certain criteria). Under recently passed legislation, California requires public pension plans to invest at least 25 percent of all new funds available in each fiscal year in mortgages on California residential real estate. Public plans can also -- as of January 1983 -- acquire employer-owned real estate.

In summary, the public accountability requirements imposed on STRSC by its enabling law and related statutes greatly exceed the requirements of H.R. 4929.

[*/] In addition, STRSC board members are each bonded for $2.5 million and are governed by the terms of the state's Political Reform Act. Under the latter, each public board or agency must adopt a conflict of interest code; STRSC adopted its code in 1978. Among other things, it requires all executive, legal and investment staff to disclose the sources of their income.

FLORIDA RETIREMENT SYSTEM (FRS)[*/]

Basic Facts:

- Number of active members: 395,000
- Number of annuitants: 73,138
- Total Assets: $6.1 billion
- Amount of monthly annuity payroll: $30.1 million

FRS is a part of the Division of Retirement of the State Department of Administration. The Division is responsible for administering the fund and distributing benefits; FRS has no responsibility for investments, which are under the State Board of Administration.[**/]

The State Board of Administration is audited on an annual basis by the State Auditor General; it retains Tillinghast, Nelson & Warren, an independent actuary, to perform actuarial valuations and to determine costs of proposed legislative changes. Valuations are completed every three years. Legislative oversight is performed by the House Committee on Retirement, Personnel and Collective Bargaining and the Senate Committee on Personnel, Retirement and Collective Bargaining. Florida is currently considering the creation of a Joint Legislative Committee on Retirement. The State

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[*/] In 1970, Florida merged its teacher retirement system with the other state systems for public employees; 43.5% of its active members are school district employees.

[**/] The Board is composed of the Governor, as Chairman, the Treasurer and the Comptroller. The Board is assisted by a six-person Investment Advisory Council (enacted in 1983; members not yet appointed).

Board of Administration maintains its own substantial professional investment staff.

FRS publishes a summary plan description (SPD) that is updated annually and distributed to all plan members. The SPD follows the H.R. 4929 requirements.*/ In addition, FRS publishes an annual report that includes most of the items specified by H.R. 4929 for such a report.

Florida has a Freedom of Information Act, which makes the records of the Department of Administration, as well as the Board of Administration, and the State Auditor available to the public; it also has a comprehensive sunshine act that applies to the meetings of all boards and commissions. In addition, FRS conducts an active public information program that includes the presentation of seminars on benefits to employer agencies, numerous brochures, including the SPD, that elaborate upon system administration and benefits, a newsletter and other publications. FRS makes information regarding individual retirement credits available upon request.

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*/ Among other things, Florida law specifies that: There shall be timely written notice given to any member or beneficiary whose claim for benefits under the terms of his retirement system or plan has been denied, setting forth the specific reasons for such denial. Unless otherwise provided by law, the terms of the retirement system or plan shall provide for a full and fair review in those cases when a member or beneficiary has had his claim to benefits denied. A special State Retirement Commission has been created to review FRS's denials of claims for disability and special risk benefits (firemen and law enforcement officials). Denials of other benefits are reviewed by a state hearing officer appointed by the Department of Administration.

In terms of investment standards, Florida has a comprehensive statutory scheme for insuring the soundness of state as well as local pension plans.[*] State law specifies, among other things, that the entity administering the fund holds them "in trust." Further, the fiduciary named in the plan as having authority to control its operations "shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries for the exclusive purpose of providing benefits to the participants and their beneficiaries and defraying reasonable expenses of administering the plan." The State Retirement Director is designated as the Administator-Fiduciary of the Florida Retirement System.

In addition to these general standards, Florida specifies the manner in which retirement funds must be financed, sets limitations on the range of permissible investments and defines the manner in which benefits must be related to funding (See Chapter 112 and Chapter 215 Florida Statutes and Article X, Section 14 Florida Constitution).[**] The Florida code conforms with PEPPRA in its limitations on the acquisition of employer securities and in the imposition of liability for breach of fiduciary duties.*/ Further, the state board members and employees responsible for investing FRS's assets are subject to the state Code of Ethics and are each bonded for $500,000.

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[*] Local plans are monitored by and subject to the supervision of the Department of Administration.

[**] The Florida Constitution specifies that: "A governmental unit responsible for any retirement or pension system supported in whole or in part by public funds shall not . . . provide any increase in the benefits to the members or beneficiaries of such system unless such unit has made or concurrently makes provision for the funding of the increase in benefits on a sound actuarial basis."

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*/ Section 112.317 Florida Statutes provides penalties for ". . . violation of any provision of this part, including, but not limited to, any failure to file any disclosures required by this part or violation of any standard of conduct imposed by this part . . ."

ILLINOIS TEACHER RETIREMENT SYSTEM (ITRS)*/

Basic Facts:

- o Number of active members: 104,000
- o Number of annuitants: 37,000
- o Total assets: $3.4 billion as of 12/31/82
- o Amount of monthly annuity payroll: $21 million

ITRS retains Ernst & Whinney as its independent auditor and the A. S. Hanson Company as its actuary. Audits are performed annually and actuarial valuations every five years. In addition, ITRS is subject to an active legislative oversight committee, the Illinois Pension Laws Commission (Ill. Rev. Stat. 108 and 1/2 22.801) and to periodic review by the Auditor General of the State of Illinois. In the past two years, the state legislature has enacted major pension reform legislation, including a law adopting the ERISA fiduciary standards and a law strengthening accountability standards for local pension funds.

ITRS has on staff its own investment manager and in addition, retains private sector professional investment managers (four firms for equity investments and six for fixed income investments).

ITRS publishes a summary plan description (SPD) of its pension program that is available to the public. The

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*/ Illinois also has a State Universities Retirement System with 41,319 active members, 10,565 annuitants, total assets of $1.3 billion and a monthly annuity payroll of $5.7 million. School districts in Illinois cities with populations of 500,000 or more are not covered by ITRS; Chicago is the only city falling within this category and it has its own plan.

SPD is updated annually via an appendix to the Annual Report to reflect major plan modifications as they occur.

The SPD contains all of the items required by H.R. 4929 except for a description of the relevant provisions of any collective bargaining agreement, which is not relevant. The SPD also omits the names, titles and addresses of plan trustees which are included in the Annual Report and other publications. ITRS's Annual Report includes all of the items required by H.R. 4929.

ITRS is required by law to make copies of the SPD, the annual report, trust agreements, contracts and other instruments under which the plan operates available to the public; it is also required to conduct open meetings (Illinois sunshine act) and to provide participants and beneficiaries with an annual written statement of individual benefit status. Beyond this, ITRS has a field staff that travels continuously around the state to advise teachers regarding their retirement rights; it maintains a field office and it distributes a newsletter to all members -- active and retired -- all in an effort to keep members informed regarding their benefits.

In regard to fiduciary standards, ITRS has adopted the ERISA standard (which is the standard adopted by H.R. 4929). In two respects, Illinois law exceeds that standard: ITRS trustees are required to "use reasonable care to prevent any other trustee from committing a breach of duty." (H.R. 4929 makes a fiduciary liable for the acts of a co-fiduciary only if he had knowledge or caused the latter's dereliction.) Secondly, the ITRS enabling statutes do not define any circumstances where an exception can be created to the fiduciary standards.

State laws governing ITRS generally prohibit the same insider transactions as are prohibited by H.R. 4929, that is, ITRS can only deal with interested parties if the transaction is for adequate consideration and is conducted at arm's length.*/ However, Illinois law permits ITRS to acquire employer securities up to 10% of plan assets; H.R. 4929 establishes the limit at 5%. ITRS reports that it cannot legally make loans to state or local government entities at below market rates.

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*/ Illinois also has an Executive Order (No. 3) establishing a Code of Ethics that applies to individuals in the Executive Branch of government (all Governor appointees plus staff making salaries in excess of $20,000 per year). Further, the state code prohibits trustees and/or employees from self-dealing. It specifies:

> "Interest of Trustees or Employees - No trustee or employee of the Board (Board of Trustees of the Teachers Retirement System of the State of Illinois) shall have any interest in, any gains or profits of any investment made by the Board, or as such receive any pay or emollument for his services. No trustee or employee of the Board shall, directly or indirectly, for himself or as an agent, in any manner use such gains or profits except to make current and necessary payments authorized by the Board. No trustee or employee of the Board shall become an endorser or surety or in any manner an obligor for monies loaned or borrowed from the Board." (Chapter 108-1/2 § 16-191).

MICHIGAN PUBLIC SCHOOL EMPLOYEE RETIREMENT SYSTEM (MPSERS)

Basic facts:

- o Number of active members: 272,000
- o Number of annuitants: 57,986
- o Total assets $5.3 billion (Oct. 1982)
- o Amount of monthly annuity payroll: $26.6 million

MPSERS administers teachers' benefits in Michigan but is not responsible for the investment of fund assets. Investment decisions are made by the state Department of the Treasury. MPSERS' performance is audited by the State Auditor General and the system retains Gabriel, Roeder, Smith & Company for its actuarial valuations, which are performed once a year. The state legislature has approved the creation of a permanent retirement oversight commission but has not yet appropriated funds for that purpose. The legislature has its own auditing arm that reviews the performance of MPSERS, as it does all other public agencies in the state. In addition, the state has a five-member Investment Advisory Committee that supervises the Treasury Department's investments of all of Michigan's public employee retirement systems.

MPSERS's eight-member board is appointed by the governor.*/

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*/ The Board is comprised of at least the following: State Superintendent of Education, one active teacher, one active non-teacher, one retiree or active member from the Detroit Public School System, one retirant and one representative from the insurance, actuarial or investment field.

MPSERS publishes a financial statement and a plan description which, in combination, meet most of the requirements of H.R. 4929 for a summary plan description (SPD) except for a summary of the relevant provisions of collective bargaining agreements (not relevant), the circumstances that may cause disqualification (the SPD specifies the requirements for qualification) and the procedures for appealing a denial of benefits. In regard to the latter, any denial is accompanied by a written statement of the right to appeal, as required by the state's Administrative Procedures Act.

MPSERS also publishes two annual reports, one of which is a summary statement of plan performance mailed to all retirees and the other is a detailed report distributed to school employers, which is made available to employees and retirants upon request. Measured against the annual report requirements set forth in H.R. 4929, the MPSERS does not include: a description of lease commitments and other contingent liabilities or a schedule of loans and leases in default or uncollectible. These can be obtained from the State Treasurer's office, upon request. Nor does it include a list of transactions entered into with "parties in interest", because such transactions are prohibited by law.

State law requires that a summary of the financial and actuarial condition of the system be furnished the governor, each member of the legislature, and each pension recipient. Copies of the summary are made available to the active members upon request. All board meetings are publicly announced and are open to the public. They are conducted in a public facility with agenda and materials available upon request. In addition to open records and open meetings, MPSERS conducts an active public education program that includes pre-retirement seminars and individual counseling. Estimates of benefits are provided to members annually upon request.

In regard to investment standards, MPSERS is subject to a higher degree of regulation than that proposed by H.R. 4929. Investments must be made with the care, skill, prudence, and diligence under the circumstances that a prudent person familiar with the matters would use. In addition, the fiduciary must "act with due regard for the management, reputation, and stability of the issuer and the character of the particular investments being considered." The investment ficudiary must also consider diversification of investments, liquidity, and current and projected return on investments. He is also directed to consider investments that would enhance the general welfare of the state, "if those investments offer the safety and rate of return comparable to other investments permitted under this act." Most importantly, as noted above, MPSERS's investments are subject to the ongoing supervision of the Investment Advisory Committee.

Besides subjecting MPSERS's investments to a high degree of supervision and review and to high fiduciary standards, the Michigan code limits the kinds and amounts of investments that can be made. Permissible investments include investments in stock, diversified investment companies, annuity contracts, obligations of state and local governments and other similar institutions, investment in real estate mortgages or real property and investment in certain loans. The investment authority is given a limited additional grant of investment discretion.

The Michigan Code does not include provisions regarding co-fiduciary liability (because investments are made by the State Treasurer); it does prohibit self-dealing, barring the fiduciary from benefiting from employment with the system or from any investment made by the system.*/ Michigan law does not permit state officials to waive the standards that govern MPSERS's investments.

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*/ Michigan passed a strong Code of Ethics in 1973 (Act 196-Public Acts of 1973) that applies to all state employees, board members, etc. An even more rigorous Executive Order on the same subject was issued by the Governor in 1977. MPSERS board members and employees of the State Treasurer are all bonded.

MINNESOTA TEACHERS RETIREMENT ASSOCIATION (MTRA)

Basic Facts:

- o Number of active members: 57,831
- o Number of benefit recipients: 11,268
- o Total Assets: $1.9 billion
- o Amount of monthly annuity payroll: $4.76 million

MTRA is audited annually by the State Legislative Auditor; an actuarial valuation is performed every year by Robert Flott, Actuary. In addition, MTRA is subject to oversight by the Legislative Commission on Pensions and Retirement. MTRA's board*/ does not have its own investment staff but relies on the State Board of Investment (SBI), which in turn, is guided by an Investment Advisory Council.**/

MTRA publishes a summary plan description (SPD) that is available to the public and that is updated regularly to reflect major modifications. The SPD includes most of the H.R. 4929 required items except for a description of relevant collective bargaining agreement provisions (Minnesota exempts retirement benefits from collective bargaining), citations to the relevant provisions of state law and regulation (these are available in other materials), the circumstances under which disqualification, termination, etc. occur and the procedures for appealing a denial of benefits (these are available in state statutes and regulations; in addition, members whose benefits are denied are given specific instructions at the time of denial).

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*/ The board is composed of five members elected by the membership and three ex officio members (the Commissioners of Education, Finance and Insurance).

**/ The State Board of Investment is composed of the governor, state auditor, state treasurer, secretary of state and attorney general. The Investment Advisory Council is composed of the trustees of the various state pension funds plus ten members experienced in general investment matters, the state commission of finance, two public employees and a retiree.

MTRA publishes an Annual Report that includes most of the H.R. 4929 items except for those that are not relevant to MTRA's operations. All of the basic documents that H.R. 4929 requires be made available to participants and the public are available under state law.*/ Minnesota has a government in the sunshine law, passed in 1982, that makes all MTRA board meetings open and an FOIA law that gives the public access to MTRA and State Board of Investment records. In addition to these safeguards, MTRA has an extensive public information program. It maintains 14 counseling centers around the state; it provides speakers for both active and retired teacher groups; it publishes a newsletter and topical memorandum on new developments in retirement benefits and fund performance (which are posted in school buildings); and it distributes annually to each teacher in the state a synopsis of the annual report that includes a balance sheet, a revenue statement, and various statistical summaries. Finally, individualized computer statements are furnished to each member once a year showing retirement account activity for the previous fiscal year (including salary service credit and deductions) as well as total account balance, including benefit projections to retirement.

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*/ Collective bargaining agreements and trust agreements do not exist in regard to MTRA.

MTRA does not exercise investment authority itself but relies on the State Board of Investment, which is subject to the "prudent person" rule. The standard of care imposed on the investor is that duty of care "under the circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived therefrom."

Minnesota exceeds the standards of H.R. 4929 in that it requires the board to establish a formula to ensure the performance of management personnel and to measure the return on investment. Further, the range of MTRA permissible investments is limited; the bulk of its assets (80%) can be invested only in government obligations, certain qualified corporate obligations and other types of commercial paper, and mortgage participation certificates. Up to 20% of MTRA's assets can be invested in certain more speculative investments, such as venture capital, resource fund investments and real estate ownership interests.

The Minnesota Code proscribes self-dealing for members of the Investment Advisory Council and its employees.*/

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*/ Council members are also required to file an economic interest statement with the State Board of Ethical Practices.

It specifies that "no member of the Council can participate in deliberations or vote on any matter . . . which will . . . result in direct, measurable economic gain to the member." In addition, Minnesota has an Ethics in Government statute that applies to SBI, Investment Advisory Council and MTRA officials. Minnesota does not authorize any state official to waive its fiduciary standard or any of the other laws governing SBI investments.

PUBLIC SCHOOL RETIREMENT SYSTEM OF MISSOURI (PSRSM)*/

Basic Facts:

- Number of active members: 60,000
- Number of annuitants: 15,000
- Total assets: $2.2 billion
- Amount of monthly annuity payroll: $8 million

PSRSM is audited biannually by the State Auditor and annually by the private firm of Baird, Kurtz & Dobson. The system is also subject to oversight by the recently-established Joint Committee on Public Employee Retirement. Studies are currently in progress analyzing alternative investment policies as well as ways to clarify the state retirement status.

PSRSM's five-person board**/ does not employ professional investment staff but instead retains private sector investment managers.

PSRSM publishes a summary plan description (SPD), which is updated regularly to reflect major modifications (most recent modification was 1982). The SPD includes all of the items required by H.R. 4929 except for the name of the person designated as agent for service of legal process and a description of the relevant provisions of any applicable collective bargaining agreement -- both of which are irrelevant.

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*/ PSRSM is only mandatory in those cities of less than 400,000. Kansas City and St. Louis are the only two cities falling in this category and each has its own pension fund.

**/ The board is composed of two members elected by members or retirees and two appointed by the state board of education. The Commissioner of Education sits ex officio.

PSRSM also publishes an annual report that includes all of the relevant items required by H.R. 4929. It does not include agreements with persons who are "parties in interest" (against the law); a description of plan termination provisions (plan won't terminate unless state law is amended); a list of leases in default or uncollectible (the plan is barred by state law from owning real estate) or information regarding insurance company provided benefits (there are none). PSRSM also publishes a newsletter and various handbooks and has a field staff that travels to the districts -- all designed to keep members informed regarding the plan's operations. All PSRSM records, as well as its meetings, are open to the public under Missouri's recently enacted government in the sunshine law. As a result of board policy, participants are provided an annual statement of their individual benefit status at least once a year.

PSRSM's board members are designated trustees by state law and perform as fiduciaries governed by the prudent person standard. PSRSM is restricted in terms of the investments that it can make; these include: bonds with sufficient security, state, county or school district bonds, accounts of savings and loans associations, and investments generally permitted to life insurance companies. State law prohibits self-dealing by members of the board or their companies and requires the board to "safely preserve" funds collected for the system. The board interprets this as prohibiting below-market loans to state and local governmental entities or similar below-market investments. State law does not permit the board to depart from the prudent person standard.

TEACHERS PENSION AND ANNUITY FUND OF NEW JERSEY (TPAF-NJ)

Basic Facts:

- Number of active members: 108,451
- Number of annuitants: 28,049
- Total Assets: $6.9 billion
- Amount of monthly annuity payroll: $20.5 million

The New Jersey TPAF administers the benefit program for the fund but does not have responsibility for investment decisions. Investment decisions are made by the Division of Investment, Department of the Treasury, which is under the jurisdiction of the State Investment Council. The Division of Investment is audited annually by Ernst & Whinney and by the State Auditor in the Office of Fiscal Affairs. Actuarial valuations are conducted annually by the George B. Buck Company.

The ten-person State Investment Council*/ formulates investment policies and procedures to be followed by the Director of the Division of Investment and his staff. These regulations are published in the New Jersey Register and are on file with the Secretary of State; in addition, the Director of the Division prepares a monthly report of all transactions effected by the Division. The report, which lists all sales, purchases, exchanges and commissions paid by the Division for all of its transactions is provided to the Legislature, State officials, the press and the public.

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*/ Five members of the Council are appointed by the Governor and five are appointed by the state's five pension systems. At least three of the Governor-appointed members must be qualified by training and experience in the field of investment and finance. The Council nominates candidates for the job of Director of the Investment Division; the state Treasurer makes the final selection.

The TPAF-NJ publishes a summary plan description (SPD) that includes most of the items required by H.R. 4929; those items that are not included can be found in the annual investment report, in the regulations promulgated by the State Investment Council, or in other publications. The SPD is updated on a regular basis to reflect major modifications to the plan. The latest update was completed in 1983.

In addition to the monthly statement of transactions (see above), the State Division of Investments publishes an annual report which includes all of the relevant items required by H.R. 4929. Not included are a description of agreements with "parties in interest" (which are against the law), a description of the termination plan (termination is not authorized by state law); or a complete actuarial report. The latter is available upon request. Virtually all plan documents are available under New Jersey's Freedom of Information law; in addition, the meetings of the State Investment Council are governed by the state's sunshine act and are open to the public. Under plan policy, participants are entitled to an annual statement of their individual benefit status. The State Division of Investments makes its audited financial statements and the statistical supplement to those statements available to any member of the public upon request.

The State Division of Investment's decisions are regulated by state law and by regulations promulgated by the Investment Council. Permissible investments include: obligations of the United States government, certain obligations of the Canadian government, and bonds and other evidence of indebtedness which are authorized investments for savings banks in New Jersey. Recently the law was amended to permit investment in property of any nature, provided the fiduciary (the Director of the Division of Investments) exercises that degree of care and judgment under the circumstances then prevailing which persons of ordinary prudence and reasonable discretion would exercise. Current regulations of the State Investment Council limit the investment authority of the Director in common stock to not more than 25% of the book value of any one pension fund; the regulations also set criteria for investments in long-term and short-term debt obligations. In regard to mortgages, Council regulations require that, in almost all cases, the securities must be directly or indirectly guaranteed by the federal government. The New Jersey Code prohibits members from profiting from their services on the Council; in addition, the State has a strong conflict of interest law that applies to all governmental officials, including the Director of the Division of Investments and his staff.

NEW YORK STATE TEACHERS RETIREMENT SYSTEM (NYSTRS)

Basic Facts:

- Number of active members; 184,586
- Number of retired persons: 50,760
- Total assets: $11 billion
- Amount of monthly annuity payroll: $40 million

NYSTRS retains Coopers & Lybrand as its independent auditor and Albert Alazraki as its actuary; audits and actuarial valuations are performed annually. In addition, the plan is subject to review by the Permanent Commission on Public Employee Pension and Retirement Systems, and is supervised by the New York State Insurance Department and the State Department of Audit and Control.

NYSTRS's nine-person board[*/] employs its own professional investment staff, and retains private sector investment managers and investment advice.

NYSTRS publishes a summary plan description (SPD) which is updated regularly to reflect major modifications. The SPD contains all of the items required by H.R. 4929 except those that are not relevant. The latter include: the name of the agent designated for service of legal process (not relevant to public entities), the names of the plan

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[*/] The NYSTRS board by statute must include: an executive officer of a bank authorized to do business in New York; members of a New York School Board who must have financial experience; administrative officers of the New York State School System; representatives of the System's membership; and the state controller or his authorized agent.

trustees (these appear on numerous other NYSTRS documents), a description of the relevant collective bargaining agreement provisions (New York, by law, prohibits the inclusion of pension benefits in collective bargaining; further, roughly 845 employers, each of which have one or more separate agreements, contribute to NYSTRS); citations to the applicable state laws (these are summarized but are not cited, in addition, NYSTRS makes a compilation of the relevant laws available to the public; the laws are also available in any New York public library as well as in large school systems).

All records of the NYSTRS board, except those designated confidential, are open to public inspection, and board meetings are open to the public. NYSTRS is required by law to furnish the state insurance department a detailed annual report on its assets, liabilities, investments and general performance; this report is available to the public. In an effort to explain its operations and respond to public inquiries, NYSTRS provides extensive additional information services: in addition to the Albany office, it schedules consultations for members and retirees at 26 locations throughout the state (9,300 consultations in 1982), offers workshops and presentations (60 during 1982) and publishes a quarterly newsletter as well as two publications that are distributed by school employers. In addition, NYSTRS publishes an annual report and a comprehensive list of investments. These documents, taken together, cover all of the items required by H.R. 4929 for an annual report except those that are irrelevant. These include agreements with "parties in interest" (against the law), provisions for termination of the plan (the plan will continue until state law terminates it); and information regarding insurance company provided benefits (not applicable). By internal policy, NYSTRS makes a statement of individual benefit status available to members on an annual basis.

NYSTRS board members operate as trustees of the fund assets.*/ With respect to 95% of its assets, state law specifies the classes of investments that may be acquired, which are generally those permitted to savings banks (including, for example, U.S., state and certain local bonds, notes, realty, mortgages, etc.), with certain specific limitations. State law permits the board to act in accordance with the prudent person standard for the remaining 5% of the System's assets.**/

NYSTRS has vigorous restrictions on self-dealing that apply to employees as well as board members. These prohibit any direct or indirect gain or profit from board investments, any borrowing or use of funds for members, their corporations or employees, any role as surety, guarantor, or endorser, etc. In addition, NYSTRS board and employees are subject to the state code of ethics that applies to all public officers in the state.*/

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*/ If the NYSTRS board delegates investment authority to another investment manager or other fiduciary, strict reporting procedures must be followed to ensure conformance with fiduciary standards and investment policies.

**/ Under that standard, investments must be made ". . . in a manner consistent with those of a reasonably prudent person exercising care, skill and caution."

Taken together, the detailed reporting requirements, the limitations on permissible investments, the fiduciary standard and the bar on self-dealing that govern the NYSTRS operations make its investment standards considerably higher than those set forth in H.R. 4929.

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*/ NYSTRS is not prohibited from acquiring securities issued by participating employers; however, it generally prefers not to get involved in such investments.

STATE TEACHERS RETIREMENT SYSTEM OF OHIO (STRSO)

Basic Facts:

- Number of active members and beneficiaries: 279,465
- Number of annuitants: 54,519
- Total assets: $7.2 billion as of June 1983
- Amount of monthly annuity payroll: $32.9 million

STRSO is audited annually by the Auditor of the State of Ohio; it retains the George B. Buck Company as its actuary; the company conducts an actuarial valuation annually. In addition, the fund is under the purview of the Ohio Retirement Study Commission. The Ohio legislature takes an active role in pension matters and in 1981 enacted legislation broadening the investment authority of the state's retirement systems.

STRSO's nine member board employs 12 professional investment staff and, in addition, retains private sector professional investment advice.*/

STRSO publishes a summary plan description (SPD) that includes all of the items required in PEPPRA except for those that are irrelevant (*i.e.*, the person designated as agent for service of process and the relevant provisions of the applicable collective bargaining agreement). Major plan modifications are mailed to participants annually.

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*/ STRSO's board is composed of five teachers who are members of the system and one retired teacher. The Attorney General, the State Auditor and the State Superintendent of Public Instruction serve as ex officio members.

STRSO publishes an annual Investment Report and an Annual Summary of Benefits that, taken together, include all of the relevant items required by H.R. 4929 for an Annual Report as well as additional useful information.*/ The two reports do not include three of the items specified in PEPPRA, because they are irrelevant.**/ Both reports are distributed to all employers that participate in the system (who make them available to employees), state legislators, organizations of retired teachers, and others.

Ohio law makes the SPD, the Investment Report and the Annual Summary of Benefits available to the public on request; it also makes all of the records (as well as the meetings) of the board open to public inspection except for information pertaining to individual members and information pertaining to individual investment decisions. In addition, Ohio has a staff of ten field counselors who travel throughout the state on a continuous basis, giving briefings and responding to member inquiries (4,184 consultations were conducted during 1982 at 64 locations). STRSO also publishes newsletters directed to both active and retired teachers; and it issues employer bulletins whenever appropriate. Each member of the STRSO system has the right, under law, to an annual statement of the amount credited to his individual account, upon written request. STRSO issues such a statement annually.*/

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*/ Ohio's Investment Report has recently been rated as meeting the highest disclosure standards.

**/ Non-relevant, excluded items are: agreements and transactions with "interested parties" (prohibited by law); information regarding insurance company provided benefits (there are none); and plan termination provisions (prohibited by law).

In terms of investment policy, STRSO goes considerably beyond H.R. 4929. It requires that members of the retirement board be bonded for acts of fraud or dishonesty in the amount of one million dollars (the system also carries Fiduciary Insurance and directors and officers coverage). Further it specifies the range of investments the board is authorized to make, listing the permissible investments and qualifying each of those to insure that fund assets will be protected (H.R. 4929 only lists prohibited investments). The STRSO fiduciary standard and the prohibitions against insider transactions are the same as those included in H.R. 4929.**/ STRSO permits insider transactions, but only if the terms and conditions of the transaction are those that would be negotiated if the transaction were at arms length. Unlike

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*/ These statements are very comprehensive and include: the value of the member's account, earned service credit, purchased service credit, and free service credit, (e.g., military credit) as well as an estimate of retirement and disability benefits.

**/ Prohibited transactions and co-fiduciary liability are spelled out in Section 3307.14 (C) and (D) of the Ohio Revised Code. Section 3307.15 of the Code specifies that fiduciaries must discharge their responsibility with respect to STRSO funds "solely in the interest of the participants and beneficiaries." Finally, the STRSO board has adopted a statement of Investment Objective and Policy that prohibits fund staff from acting or personally investing in any way that creates a conflict of interest.

H.R. 4929, STRSO does not authorize any state official to exempt the plan from any of the fiduciary or investment requirements. The STRSO board is authorized to consider "investments that enhance the general welfare of the state and its citizens" but only if those investments offer "quality return and safety comparable to other investments currently available to the board." The plan administrators interpret this to prohibit below market investments or loans, even if such loans would benefit the state.

The Ohio Retirement Study Commission, in a soon to be published assessment of the extent to which current Ohio regulation of public plans meets the H.R. 4929 standards, has concluded that STRSO meets or exceeds the reporting and disclosure requirements of that legislation, as well as the fiduciary standards.

PENNSYLVANIA PUBLIC SCHOOL EMPLOYEES RETIREMENT SYSTEM (PPSERS)

Basic Facts:

- Number of active members: 205,438
- Number of annuitants: 79,168
- Total assets: $6.26 billion (June, 1983)
- Amount of monthly annuity payroll: $40.5 million

PPSERS retains Peat, Marwick, Mitchell & Co. as its independent auditor and George B. Buck as its actuary; audits and actuarial valuations are performed annually. The plan is also subject to oversight by the Public Employee Retirement Study Commission (created in 1981). The Commission has recently recommended a major legislative reform package.*/

PPSERS eleven-member board**/ does not hire its own investment staff but relies on private sector professional investment managers (eight different companies).

PPSERS publishes a summary plan description (SPD), and notices participants regarding major modifications to the plan. The SPD contains all of the items required by H.R. 4929 except for: the name of the person designated for service of process (not relevant); the names and backgrounds of the plan trustees (available in many other plan publications); relevant provisions from collective bargaining agreement (not relevant); citations to the relevant state laws (all of the laws are available in a separate compilation), and the date of the end of the plan year (available in the Annual Report).

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*/ The major thrust of this legislation is to protect and improve the performance of municipal retirement systems.

**/ The board is composed of two members appointed by the governor, one elected by the non-professional plan members, one elected by annuitants, one member of a school board, four members from the legislature and three active members (teachers). In addition, the Secretary of Education, the State Treasurer and the Executive Director of the Pennsylvania School Board Association serve ex officio.

PPSERS publishes and distributes an Annual Report that includes all of the items required for such a report by H.R. 4929. In addition, the records of the PPSERS board are open to the public, as are its meetings, which are governed by the state's sunshine law. The PPSERS enabling statute requires the plan to furnish annually to each member a statement of his account and the service credited to his account. PPSERS also conducts an active public information program that includes a field staff of six officers, regular regional retirement seminars and the publication of four newsletters (for active members, employers, retirees and legislators) as well as periodic news releases.

PPSERS is governed by a high fiduciary standard that is superior to PEPPRA.*/ The Pennsylvania Code specifies that board members are trustees, serving in a fiduciary relationship to the members of the system. In regard to investments in corporate stocks, the Code requires that investment decisions be subject to the exercise of that degree of judgment and care under the circumstances then prevailing which persons of prudence, discretion and intelligence who are familiar with such matters exercise in the management of their own affairs not in regard to speculation but in regard to permanent disposition of the funds, considering the probable income to be derived therefrom as well as the probable safety of their capital. PPSERS is also restricted by law in regard to the level of investment it can make in any one company (no more than 2% of the book value of the fund's assets, and no more than 5% of the outstanding stocks of that company). If the board invests in real estate or mortgages, the board must "promulgate regulations . . . to ensure the safety of investments . . . which regulations shall be in accordance with generally accepted standards and investment principles of pension funds of comparable size."*/ In addition to the general requirement that all board records be available to the public, the Code specifies that all instruments and records pertaining to real estate investments must also be available for public inspection.

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*/ This standard was enacted into law in 1982.

PPSERS members and employers are governed by the state Code of Ethics; board members are bonded to protect against illegal activity. Further, PPSERS prohibits members of the board from profiting either directly or indirectly from the investments or disbursements of the system; in addition, the fiduciary standards established for members of the board are sufficiently high to preclude, as a general proposition, the specific transactions prohibited by H.R. 4929. PPSERS does not authorize any state official to exempt the board or any of its investments from the fiduciary standard.

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*/ PPSERS is permitted to invest a maximum of 10% of the book value of its assets in other investments provided they conform with the prudent person standard.

PPSERS does not specifically deal with below-market loans to state and local units of government, but plan officials regard them as prohibited under the fiduciary standards that govern their performance.

TEACHER RETIREMENT SYSTEM OF TEXAS (TRST)

Basic Facts:

- Number of active members: 395,397
- Number of annuitants: 81,376
- Total assets: $8 billion (March, 1983)
- Amount of monthly annuity payroll: $37.4 milion

TRST is audited annually by the State Auditor and receives an annual actuarial valuation from the Wyatt Company. In addition, TRST is subject to oversight by the State Pension Review Board,*/ which reviews the plan's actuarial reports and other aspects of its performance and, where appropriate, recommends corrective legislation.

TRST's seven-member board**/ employs a staff of thirteen professional investment specialists and, in addition, hires outside advisors.

TRST publishes a summary plan description (SPD) that is available to the public that includes all of the items required by H.R. 4929 except for the name of the agent for service of legal process and a description of any relevant collective bargaining agreement, both of which are irrelevant, and the names and titles of plan trustees and cites to enabling legislation -- both of which appear in other documents.[*/] Major plan modifications are mailed to participants on a regular basis; the latest one was in September, 1983.

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*/ The PRB includes members with experience in actuarial science, governmental finance and securities investments.

**/ The governor appoints all of the members of the board: two from a slate of three members currently employed by the schools; one from a slate of three retirees; one from a slate of three members from higher education and three others (with no statutory restrictions).

TRST also publishes an Annual Report that includes all the relevant[**/] items required by H.R. 4929 except for the funding policy in effect for the year. All of the TRST records are available to the public under an Open Records law, as are the records of the State Pension Review Board pertaining to TRST. Both boards are also required to hold open meetings. In addition, TRST publishes a monthly newsletter, a number of pamphlets explaining the benefits available and a compilation of the laws and regulations that govern the system. In Texas, each member is entitled to a statement of the amount credited to his individual account once each calendar year.

TRST is created by the state constitution, which specifies that "the assets of the system are held in trust for the benefit of the members and may not be diverted." The

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[*/] For example, TRST publishes a separate compilation available to the public of the state constitutional provisions, laws and rules that govern its operation.

[**/] Non-relevant provisions include transactions with parties in interest, which are prohibited by law, termination provisions, which don't exist, and information re leases in default and re insurance company provided benefits, neither of which exist. A schedule of loans in default or uncollectible would be provided if any existed, but generally there are none.

constitution also requires the fund to operate on a sound actuarial basis and specifies the investment standard governing the fund. It must exercise "the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income therefrom as well as the probable safety of their capital." And, state law subjects TRST's board to general fiduciary standards by specifying that the board "is the trustee of all assets of the retirement system." In addition to defining a general fiduciary standard, the state code also includes provisions that direct the board in regard to the way in which it manages the fund.

TRST's investment discretion is controlled by the standards described above; the Texas Code does not specify a list of permissible investments.*/ TRST is prohibited from "self-dealing" and its Trustees may not "have a direct or indirect interest in the gains from investments made with the system's assets and may not receive any compensation for service other than designated salary and authorized expenses." In addition, Texas has recently enacted an ethics in government law that applies to all state officials, including the TRST trustees.

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*/ The Texas Constitution does, however, prohibit the TRST from taking an equity ownership position in real estate investments.

Because of the constitutional mandates established for TRST, the fund cannot make below-market loans or other investments in state or local governmental entities, regardless of the social desirability of such investments. In this respect, TRST is in direct conflict with the provisions of H.R. 4929 permitting the Secretary of Labor to waive fiduciary and other standards.

UTAH STATE RETIREMENT BOARD (USRB)

Basic Facts:

- Number of active members: 79,464
- Number of annuitants: 12,085
- Total Assets: $1.5 billion (April, 1983)
- Amount of monthly annuity payroll: $3.2 million

USRB retains Peat, Marwick, Mitchell & Co. as its independent auditor and Coate, Herfurth & England, Inc. as its actuary. Audits and actuarial valuations are completed yearly. In addition, any member of the legislature can request the State Auditor General to do performance and organizational audits and its performance is reviewed on a regular basis by the Retirement Subcommittee of the State and Local Affairs Committee.

USRB's nine-member board[*] hires its own professional investment staff and, in addition, retains private sector professional investment managers and advisors (the 1982 Annual Report listed five companies as investment advisors).

USRB publishes a summary plan description (SPD) that is updated continuously (most recent update -- 1983), with notice to participants. The SPD contains all of the items specified in H.R. 4929 except for descriptions of relevant provisions of a collective bargaining agreement (not relevant) and the date of the end of the plan year (available in other documents).

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[*] Utah's board includes representatives of the investment community, of public (non-school) and school employees and of employing units; the State Treasurer also sits on the board.

USRB also publishes an annual financial report that contains most of the items required by H.R. 4929 except for those that are not relevant to Utah. The financial report gives a detailed, item-by-item list of board investments. The plan documents that would be made available to members and to the public under H.R. 4929 are also available under Utah law; the state has laws requiring that all meetings and records of the board be open to the public. In addition to these protections, USRB conducts a public information program that includes employer briefings, employee consultations via a traveling field staff and newsletters, and other publications -- all designed to keep participants and beneficiaries informed regarding their benefits and the performance of the system.

In terms of investment standards, Utah enacted the ERISA prudent person rule in 1983 (the same standard as is proposed for H.R. 4929). USRB is given wide discretion in choice of investments. The state code specifies that the board can invest in bonds, securities, real estate mortgages, savings deposits or certificates of deposit and similar types of instruments. In addition, the Code permits the board to invest in unrated securities where "such unrated securities are found by the board to be of a quality equal to securities rated within the three highest classifications as required of rated securities." Utah law does not permit any state official to waive or otherwise override the statutory fiduciary standard.

The state code prohibits self-dealing in its public employees Code of Ethics. This act has rigorous terms, including a provision that voids transactions where there has been a conflict of interest.*/ USRB members are covered by a fiduciary bond policy that provides $15 million in coverage for legal fees and $15 million aggregate coverage. A fidelity bond also provides coverage for up to $1 million.

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*/ USRB members are designated by state law as trustees, dealing as fiduciaries with trust funds. As such, they come under the state trust laws.

Mr. RANGEL. Thank you.

Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman.

Mr. Martin, I would like first of all to commend you and agree with you that the guidelines of the MFOA are perhaps the best and most comprehensive set of reporting standards around.

In that vein let me ask you, out of these 6,600 plans, how many have received a certificate of compliance this year?

Mr. MARTIN. I am probably not the best person to answer, but my memory would be under five that I would be personally aware of.

Mr. CLAY. So, only about five adhere to this higher standard?

Mr. MARTIN. As you noted, it is a Cadillac standard. This is the highest standard of reporting. Yes, only a small number have attained that level of reporting.

Mr. CLAY. So, the rest of almost 6,600 fall somewhere between a Volkswagen and a Cadillac, and Volkswagen is an imported car, too?

Mr. MARTIN. Except those made in Western Pennsylvania.

Mr. CLAY. Oh, you mean Volkswagen? Oh, yes, yes.

Mr. Baker, does your system follow the MFOA guidelines?

Mr. BAKER. I am not sure they do exactly. I think we substantially comply with them.

Mr. CLAY. Have you been certified or have you applied for certification?

Mr. BAKER. No, we have not.

Mr. CLAY. Any reason why not?

Mr. BAKER. I cannot answer that question. I will be happy to have the executive director give you that information. There is a charge, somebody told me.

Mr. CLAY. Do you value your assets at market rate?

Mr. BAKER. In our annual report we have two valuations. We give them at the cost and we also have valuation at the market rate.

I understand that even under ERISA that that approach is permissible.

Mr. CLAY. That is correct.

Mr. Martin, State Senator Howard from your State was reported in the press as saying that Pennsylvania has nearly two-thirds of the Nation's municipal pension fund systems and that half of them are in trouble.

Are you familiar with that quote and is that an accurate statement?

Mr. MARTIN. I am familiar with Senator Howard. He serves on the pension committee with whom I work.

To add emphasis to the problem that Pennsylvania is now attempting to address, I think he may well have overstated the matter a bit.

We do have in excess of 2,100 pension plans, a small number greater than that. We have recently, in 1982, done a complete collection of data on those. The report on that will be available sometime shortly after Thanksgiving.

Based on our best look at the data coming in for 1982, what we would term financially distressed would be maybe 10 percent of our local plans, maybe in the nature of 200 plans.

Mr. Clay. Did you also say that some had technically defaulted, but you are not aware of any that are not paying retirees, some are hand to mouth, having to make transfers from city revenues each month?

Mr. Martin. There are some plans, especially in western Pennsylvania, that have great difficulty with cash flow problems and having to make a technical default where they have been late making pension payments.

Mr. Clay. This is not significant enough and widespread enough for the Federal Government to become concerned?

Mr. Martin. This is something that the State of Pennsylvania is very concerned about, the primary reason for the establishment of the Pennsylvania Commission, the mandate within 1 year of its creation to recommend legislation to address the problems of financially distressed municipal pension systems and why we have a substantial legislative package before the General Assembly which they are now working on.

Mr. Clay. It is true that there is a significant problem there with underfunded liability?

Mr. Martin. We would view it as a substantial problem. It is in the neighborhood of $2.5 billion of a pension deficit. Most of that lies with the city pension plans.

At the same time we also have a problem of a very inequitable distribution of current State aid given to local pension plans which we are also trying to address to better use State dollars to meet the need rather than overfunding some of the plans.

I think you will find as many overfunded pension plans in Pennsylvania as you will find distressed plans. What we have is a feast and famine situation which the State of Pennsylvania is now trying to straighten out.

Mr. Clay. Is that unfunded liability increasing to the tune of $150 million a year?

Mr. Martin. Yes.

Mr. Clay. Do you think you are going to get everything under control?

Mr. Martin. Yes, sir; with the funding standards which are based on very extensive reporting done on a biannual basis and a very strong legal requirement for each municipality to meet funding standards and also, for those plans which are in desperate shape, the establishment of a $35 million annual fund which would then provide additional assistance to 200 municipalities that have difficulty.

Mr. Clay. Thank you.

I have no further questions.

Mr. Rangel. Mr. Pickle.

Mr. Pickle. Thank you, Mr. Chairman.

Mr. Chairman, ERISA legislation has been good legislation. It was needed and it is serving a very useful purpose.

I don't think that ERISA has cured all of our problems. We have organizations like the Teamsters Fund that is so big and so huge that it would take several Philadelphia lawyer firms to try to get to the bottom of it. It is almost bigger than the Government.

But it has improved and ERISA has been helpful. Although we passed ERISA, it has not solved all the unfunded liabilities of that pension program or others related to it.

Indeed, the unfunded liability of pension programs is enormous.

It must be clearly understood just because we passed ERISA, we have not settled the unfunded liability of all these private plans, not by any means.

The inference should not be drawn that because we have State-regulated plans that therefore there is a huge unfunded liability.

When we passed ERISA, in my judgment, and I have been very active in this over the years, we attempted to set up strong requirements for plans, for reporting, for fiduciary standards and protection against abuse of assets. It has served well.

We have never said that we were going to cover public plans. It was never recommended that it cover public plans, but that we ought to have a study and examine whether they should be included.

That is the purpose, I assume, of this hearing. I have the feeling today that some would say we are guilty because we do not cover public programs. Yet that has not been the recommendation of Congress to date.

This morning quite often it was said there has been wrong doing, laws have been broken, or the intent of the law has been broken.

Yet we never have recommended it. We ought to look at it in an objective manner. I would hope that that is the way we could look at it.

I have talked to Mr. Baker and some of my State agencies. I will take the position that every State must have a strong plan, should have a reporting requirement, should have protection of these assets and investments.

We ought to have a fiduciary requirement that is responsible and all the other protections that any employee should have to be certain money is there when they get ready to retire, whether in the government field or private field. That is what we ought to ask for.

If that is provided on a State level, then I think that is important.

I don't think we ought to conclude the only way to do it is to establish Federal standards. Surely there is some program under this sun that covers this great land to which you don't have to reach out and impose Federal standards in every instance.

If we are not doing the job and cannot do it locally, then you will get Federal standards because the employees are entitled to that protection.

I am not going to try to ask you a lot of questions because we have other witnesses and we have limited time.

I want to ask you a question regarding the oversight for the public pension plans in Texas. What protection is there for the employees in these four or five large statewide programs?

Mr. **Baker**. Congressman Pickle, there is a Pension Review Board which has been created for 5 years by the legislature mainly composed of people outside the legislative process.

There are two representatives—one from the State House of Representatives and one from the State Senate—on the Board. There are about nine total members.

So, you have representation in specific areas of people specializing in investment, in actuarial matters, and in pension administration.

Mr. PICKLE. Do they meet regularly?

Mr. BAKER. They meet on a regular basis. They study the State and local plans, study how the records are kept. We report to them various financial information and also they cover legislation that is introduced. They have to attach actuarial notes to all legislation and amendments that will affect pension benefits.

They report basically to the legislature, but they also give reports to the Governor's office, and by the way, all the State pension systems, I believe, also submit reports to the Governor's office and are audited by the State.

Mr. PICKLE. Have you any instances of losses or unfunded liabilities that you have not been able to handle?

Mr. BAKER. Every pension system generally has an unfunded liability. In fact, it is a rare actuary that would say you should have no unfunded liability. Otherwise you impose a liability on one generation to fund all the benefits.

There are local systems that have had some problems in the State of Texas. This is one of the reasons for the Pension Review Board being created.

The legislature uses the Pension Review Board in fact. They don't give benefits that they can't afford. They can point to the Pension Review Board and say this says it is unwise to pass these particular benefits.

Legislators are concerned whether a proposed change is actuarially sound or not.

Mr. PICKLE. Is there any possibility that proposed Federal legislation along whatever lines it might be submitted could weaken the present protection available to State employees?

Mr. BAKER. Mr. Pickle, I think that it could. That was really the basis of some of the remarks that were apparently objected to by a previous witness.

The State of Texas has constitutional protection applying to statewide pension systems that require a prudent person standard for investments.

It is my opinion that this prudent person standard would mean that a system could not invest in employer securities at a lower rate than the market rate would justify.

In my opinion, PEPPRA introduced last time would permit that with the approval of the Secretary of Labor.

In order to do that in Texas, bail out an insolvent local government or an insolvent State government, for that matter, it would be necessary for a constitutional provision to get a two-thirds vote in each house of the legislature and receive a majority vote of the people.

It would be much easier, it seems to me, to get the Secretary of Labor to approve such a bail-out because in the example of New York City I believe they had approval from a Federal agency.

We just think it might be another way to go about encouraging social investing to that extent. We think that the constitutional protections we have are very strong in that regard.

Mr. **Pickle**. Thank you, Mr. Chairman. My time is up.

Mr. **Rangel**. I should point out it was a Federal agency relating to New York City. It was Federal legislation, not State legislation and city council legislation.

Mr. Bartlett.

Mr. **Bartlett**. Mr. Baker, we have heard testimony this morning essentially along two lines.

One would have Federal legislation simply requiring reporting disclosure and fiduciary obligations.

The other would add on top of that all manner of vesting and portability standards.

I want to separate those two.

Do you believe, first of all, in your mind, are the various plans of the State of Texas adequately providing for their employees with regard to reporting, disclosure, and fiduciary obligations?

Mr. **Baker**. Yes, I think they are. There are provisions in the State law requiring disclosure very similar to provisions in this legislation.

Mr. **Bartlett**. So that requirement for those three areas would have no benefit to the employees of the State of Texas?

Mr. **Baker**. I don't believe that it would.

Mr. **Bartlett**. You are concerned that any Federal legislation, if it were improperly drawn, could in fact have a detrimental effect, to say nothing of the paperwork?

Mr. **Baker**. That is correct.

Mr. **Bartlett**. On the other side of it you would be, I suppose, even more fervent in your opposition to adding standards, Federal standards on vesting or portability that we have been discussing here today?

Mr. **Baker**. I think the State provisions we have would provide the benefits and I think that can be resolved at the State level.

Mr. **Bartlett**. I thank you.

Mr. **Clay**. We certainly want to thank you for your testimony.

Mr. **Baker**. Thank you, Mr. Chairman.

Mr. **Clay**. The next witnesses will consist of a panel. Daniel Halperin of Georgetown University Law Center, and Roy A. Schotland, Georgetown University Law Center.

Welcome to the Committee.

Without objection, your entire statements will be entered in the record.

STATEMENT OF ROY A. SCHOTLAND, ESQ., GEORGETOWN UNIVERSITY LAW CENTER

Mr. **Schotland**. Thank you, Mr. Chairman.

Mr. Bartlett, I would like to draw attention to two Texas voices that I am putting into my statement.

One is the chairman of the Texas Pension Review Board who blasted the lack of accountability from board trustees to staff and to the public. I am quoting from a report of his talk this past August:

"Few pension plans know how well or poorly they are doing."

Down to page 16, I quote a letter from the Executive Director Horowitz of the Texas Pension Review Board saying that our State systems are OK, but not our city systems.

I would be happy to work with you and Mr. Pickle looking at some of the reports of some of the cities in Texas to establish on the record, get out the facts, whether there are or are not severe inadequacies in the information that is made available.

Now, what we are talking about here is pure Sergeant Friday legislation, getting out the facts.

The reason I speak of Sergeant Friday legislation is I am troubled about Mr. Rangel's talking about antidiscrimination.

I understand what he is getting at. I have written the only public study of the congressional system. Your system is not so bad, by the way.

I am troubled to hear talk about funding, and so forth. I am even sorry to hear people still talking as much as we are about fiduciary provisions, though a book which has been cited several times here is one which I edited, on conflicts of interest in these areas.

It seems to me the route that could get us a bill and accomplish disclosure, is to take out the cop-out provision that was snuck in a few years ago allowing each State to say that it complies, and perhaps have it administered with strictly disclosure either by GAO or ACIR or by the Department of Labor or by the IRS, but there are two candidates to administer disclosure in GAO and ACIR that can do the job very well.

It matters what kind of disclosures we have about investments. In the past 5 years assets have gone up 99 percent. We have $320 billion in the State and locals. Receipts have gone up 93 percent. Investment income has gone up 250 percent. Investment income is over half of the receipts for more and more systems. It is now over 40 percent of the income for all systems throughout the country.

This is the best kind of income because it means you are not fighting in the budget process over how much public employees get and how much other people get.

The management of those assets has to be kept accountable. You can't be running $320 billion without watching what is going on.

The Ohio State teachers bring out in their excellent annual investment report that 1-percent improvement in investment return means a 10- to 15-percent improvement in benefits or a 10- to 15-percent reduction in taxpayers cost or, in popular words, something for everybody.

We have practices out there that are very troublesome. We have practices in broker-dealer allocation which is not exactly an unsensitive political issue.

I am told top brokerage firms are getting over 30 cents a share in the business from the public systems. There are major public firms available to do that at 7 cents a share. The broker-dealer charges should be disclosed.

Turnover should be disclosed. I note in my statement a $2 billion fund which ended June 1982 with half a billion dollars' worth of stock. During the year they bought 512 million dollars' worth of stock and sold 456 million dollars' worth of stock. They ended the year with 900 million dollars' worth of bonds. During the year they bought $1.6 billion and sold $1.4 billion. I don't know if it is churning or not. If I were in that State, I would like to know what it was.

We had problems which were referred to earlier with the in-State mortgage packages. Texas is one of the few, if not perhaps the only State which participated in these kinds of MGIC packages which did not descend to giveaways.

In fact, we have 31 States participating, many of whom I am afraid are giving away taxpayers money without aid to homeowners and without aid to the construction industry. Many did nothing but take old mortgages off the shelf, allowing money to go out to Treasury bills, not housing.

This was brought out a year and a half ago by the South Dakota Retirement System Investment Council, a very full study which Ms. Munnell's publication updates, usefully updates, but I think South Dakota is entitled to some credit for this.

I also give in my statement examples of outstanding disclosure. I think we ought to make more of that kind of thing.

I would like the record to be open, with your permission, to include the annual summary report which the Ohio State teachers send to their several, I think it is, hundred thousand—if it is not several hundred thousand, close to it—participants which is the best summary report.

What they get into a little folder that goes into an envelope with their check is astonishing in the way of actuarial information, financial information and benefits information.

It is also one of the few systems in the country that is willing to compare how benefits have fared relative to inflation. And their new annual report on investment is a major step forward.

I have substantial excerpts at the opening of my exhibits, showing the nothing-less-than-astonishing advance that "scrappy" South Dakota has made with its latest investment report showing its returns and risk assumed.

The NCTR questionnaire which will be in the record ought to be noted as a fine questionnaire covering very important areas, but not really getting into the nitty-gritty of the investment area with anything like accuracy. Anything it brings out on investment information, I am afraid, will have to be amplified by further material.

[The statement of Mr. Schotland follows:]

STATEMENT OF ROY A. SCHOTLAND, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY

"NO ONE REQUIRES ANYTHING"—DISCLOSURE PRACTICES ARE "INADEQUATE AND CONFUSED AND CLEARLY IN NEED OF REPAIR"

Last week, the National Education Association held its annual Retirement Forum for trustees of state and local teachers' retirement systems and other persons involved with retirement systems. A presentation on "Disclosure: Who Requires What?" by Gary Findlay of a leading consulting firm, opened simply: "If my talk is only about 'Who Requires What,' it will be short and simple. No one requires anything." Findlay chaired the Municipal Finance Officers Association's 1980 "Guidelines for the Preparation of a Public Employee Retirement System Comprehensive Annual Financial Report," by far the best guidelines available. Despite the authoritative MFOA sponsorship and the passage of 3½ years, only 5 (sic) of the nation's 6,000-plus state and local systems have received the MFOA's Certificate of Conformance.

Despite the efforts of the highly regarded Mr. Findlay and his colleagues, MFOA has been able to change practices only infinitesimally since 1980, when MFOA's research arm concluded after a major study funded by HUD, that:

"[A]vailable information indicates such [state and local pension systems'] reporting is today inadequate and confused and clearly in need of repair. Several factors contribute to the lack of good disclosure about [these] pension systems . . ." (John Petersen, Public Pension System Financial Disclosure, May 1980, at 3).

Of course, as I will note below, a national norm of "inadequate and confused [public pension reporting], clearly in need of repair" does not mean no systems have good reporting.

But the norm is "clearly in need of repair": for example, when I reviewed a survey of 50 states and 3 territories by NASRA (Nat'l. Ass'n. State Retirement Administrators), I found on one key item—"interest earnings on total investments"—the 33 funds which answered at all reported not on the one period sought but on 10 different time periods, and not with the one figure sought but with 30 different definitions of "earnings" for the 33 respondents!

THE FEDERAL TAXPAYER'S INTEREST IN STATE AND LOCAL RETIREMENT FUNDS' OPERATION

It is a particular privilege to participate in this first Ways and Means Hearing on PEPPRA. Having been in all four House Labor Hearings starting in 1975 and last year's Senate Finance Hearing, I hope you agree that today it is better for me not to repeat the analyses, constitutional considerations and evidence of abusive practices I have set forth previously. Rather, I will try to add new factual material showing the need for PEPPRA.

I take special pleasure in beginning by saying that I believe the crux of the entire 1,726 pages of the 1980 House Hearings was captured by Congressman Erlenborn at the very outset of that Hearing: from the first page of the first witness' testimony (Cong. Walgren's), Congressman Erlenborn pointed to this:

"We as taxpayers need to know that pension plan assets are being invested prudently with the exclusive purpose of providing benefits to the beneficiaries of the pension plan." (1980 Hearings, at 136)

That statement points up the key need for PEPPRA:

That local taxpayers must be informed, so that local political processes can operate to assure that pension assets are well-managed, so that their governments' pension promises will be honored, without turning for aid to the pension insurer of last resort: the Federal taxpayer.

The Federal involvement in state and local pension funds came out in House Labor's very first Hearings, when one of the first witnesses, Pennsylvania's Secretary of Community Affairs, suggested that the Federal Government pay for a veterans' benefit portion of Pennsylvania pensions (see the exchange with Cong. Erlenborn, 1975 Hearings at 106–7).

The Federal involvement took concrete form only months after that first Hearing, when two provisions of the Internal Revenue Code were temporarily waived by statute, to allow New York City pension funds' investments in employer securities. Those provisions (applicable to all state and local retirement funds since such funds are built up by deferral of current personal income taxes on the contributions) safeguard against diversion of these tax-favored pension assets.

The most recent Federal involvement arose in late 1981, when those same IRC provisions were used to help defend the Detroit city pension funds from improper terms in a $56 million dollar transaction to aid the city, for which IRS approval was sought and secured.

Effective public disclosure about how state and local pension assets—now about $320 billion—are being managed, is the most important first step toward protecting the Federal interest by assuring responsibility in state and local pensions. Better disclosure is the most appropriate Federal step for four reasons:

1. Effective disclosure activates local political processes, so that pension problems will be worked out at home.
2. Disclosure cannot be effective unless local taxpayers and pension participants can compare how their funds are doing, relative to other similar funds.
3. Only the Federal Government can bring us comparability of information about pension plans.
4. Required disclosure is the least intrusive and least costly form of protection. This makes it especially appropriate when, as here, the Federal Government must take some steps affecting state and local governments in order to protect the Federal taxpayers' vulnerability as pension insurer of last resort.

WHY DOES DISCLOSURE MATTER?

These funds involve $320 billion of—

Other people's money;

Money relied upon for retirement security;

Public money to meet the public provision of civil servant's retirement security;

Public money that is subject to increasing pressures for diversion to uses jeopardizing retirement security, pressures which over the last two years have resulted in widespread, measurable abuses;

Public money that in too many States and localities—indeed, probably in the substantial majority—has long been managed in ways which serve the interests of firms servicing these pension funds than the interests of the participants and taxpayers;

Public money which, if inadequate to honor the promised retirement security, will lead to pressure on the ultimate pension insurer, the Federal taxpayer.

Opening last year's House Labor Hearing, AFSCME's President Gerald W. McEntee began:

"The exhaustive report of your own Task Force on Public Pension Plans, . . . and the reports of numerous other Government and private studies all underscore one essential fact: Our State and local public employee retirement systems are on the brink of a major crisis." (Hearings at 270.)

Senator Eagleton put that point most dramatically several years ago when he referred to "time bombs ticking away in every American city."

Few people realize how much of our solution lies in effective management of the assets of these systems. Consider two simple facts. First, consider how the importance of asset management is soaring:

[Dollar amounts in billions]

	1977	1982	Rise (percent)
People (million)	11 to 13	11.6 to 14.5	5–10
Assets	$123.5	$245	99
Total receipts	$25.3	$48.9	93
Investment income	$7.7	$19	250
Investment income as percent of receipts	30	39	

Source: Census Bureau and Life Insurance Fact Book.

Good news, this rapidly rising role of investment income. It means that the funding of this largest "fringe benefit" cost will be less and less a subject of struggle in budget decisions. But it means that how those assets are managed, is becoming a key question.

HOW MUCH DOES IMPROVED ASSET MANAGEMENT MATTER

The Ohio State Teachers Retirement System, not only large but a national leader in many ways, puts it this way:

Each 1 percent increase in investment return will finance benefit improvements in the range of 10-15 percent, or will allow a similar reduction in contributions. Such gain may also be used to improve the actuarial condition of the plan. (1983 Investment Report, at 22. See Exhibit 2, attached).

How can improve asset management? Three clear answers:

(1) Will Rogers' answer—"Buy low and sell high. If it don't go up, don't buy it." If that answer can't be implemented, we go to the next one.

(2) Few questions have as many people working at them and as few people coming up with good answers. Institutional investment management may be the toughest profession of all. In no other work can the best experts be second-guessed every day by any fool who can say, accurately, exactly what should have been done the day before and precisely how much those experts lost. The unusual difficulty of investment management means that certainly we should take any simple steps that will help, one of which is our next answer.

(3) Whatever else is true about a public retirement system, how the assets are being managed, and how well, should be clear and publicly available. Having the full record out in the open promotes building a better record, but there is another very important reason requiring effective disclosure: the management of these assets must be accountable.

THE NEED FOR ACCOUNTABILITY, AND EXAMPLES OF DISCLOSURE LUDICROUSLY FAILING TO PROMOTE ACCOUNTABILITY

The need for accountability has never been put more tellingly than by Texas Pension Review Board Chairman Charles Miller, to the National Conference of State Legislatures this August:

"Miller blasted the lack of proper accountability from the board of trustees internally to its staff and externally to the public. Few public pension plans really know how well or poorly they are doing, he said. Many funds still are using a cost method for valuing assets, and do not even attempt to measure performance by such standards as time-weighted rate of return."[1]

Having earlier noted the sad state of existing disclosure practices, brevity precludes giving typical examples proving how right Mr. Miller is, but real appreciation of the situation and wry amusement should come loud and clear from these few examples:

(1) A state treasurer's report disclosed an endless array of balance sheet data, e.g. month-by-month cash balances, and the number of citizens' phone calls and visits to field offices for assistance, annually and month-by-month; but no investment performance data.

(2) A state retirement board report gave inconsistent performance figures on different pages; explained what each of its six main actuarial assumptions mean but then omitted to reveal what were the assumed figures; and reported that the report itself cost $27.50 per copy to produce, for a total of $19,250 publication cost.

(3) A state treasurer's report disclosed only one year's equity performance, two years' bond "performance" using only the cost values—but reported fully on the 92,137 pages and 2,084,085 lines produced by the word processing center.

(4) A state Department of Insurance (for its report of examination on public employee pension funds) reported not only aggregate dollar amounts of equity holdings but also the aggregate amount of shares (e.g., 100,000 AT&T, plus 200,000 GM, plus 300,000 XYZ=600,000 shares); which also said that the State's small funds invested wholly in fixed-income securities had done well because 1979-81 was a good period for such investments (!); and above all, which screamed about the worsening health of the State's public funds because their unfunded liabilities had continued to rise, but looked only at absolute dollar figures and ignored the fact that the ratio of assets to unfunded liabilities had improved from 40% to 52%.

EXEMPLARY DISCLOSURE

Better to consider examples of good disclosure. Few as they are considering that we have over 6,000 state and local systems—or even considering only the 50 state systems—we do have examples worth copying.

(1) South Dakota—"scrappy" and financially innovative with impressive results, according to the latest issue of Forbes magazine—State Investment Council has just brought out what is by a wide margin the finest public retirement system report ever produced on how the assets are being managed. Not only 10-year data on total returns, on equity returns and on bond returns but also state-of-the-art data on the risks assumed to secure those returns. And on asset allocation. And on 10-year comparison with the results of the largest available "universes" of other state funds, other public funds, and of all pension funds.

See Exhibit 1, attached.

(2) Ohio State Teachers has the best summary annual report to participants, loaded with financial information, clear enough to be read, and concise enough to be mailed out with retirement checks.

Ohio STRS also has the best reporting about benefits, including the key item almost all systems prefer to ignore: how participants have fared vis-a-vis inflation, for over 50 years.

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[1] Miller's concern about whether the staff, let along the public, know how well or poorly their own plan is doing, applies even to the trustees themselves. Anyone familiar with these plans will know how understated it is to say that far too many trustees are not sophisticated enough nor well enough informed.

For example, in February I shocked persons affiliated with one of the largest and finest state systems when I pointed out that in the prior year, they had had an unrealized loss of about $1 billion in their bond portfolio. Happily, the latest annual report from that system is revised so that no one could fail to appreciate its market as well as book values.

The need for savvy trustees grows steadily more acute. We cannot afford amateurism or inattentiveness at the helm of such massive funds. Professionals seeking to service these funds are far from inattentive. For example, at September's annual meeting of the National Confernece on Teacher Retirement in Palm Beach, about 700 attended, of whom 312 were vendors.

And Ohio STRS has the most sophisticated, informative disclosure of their investment policy, see Exhibit 2, attached.

Also:

Colorado, Minnesota, Montana, Ohio STRS and Virginia compare their returns not only to the customary indexes, but also to comparable funds, a crucial item.

California State Teachers, Minnesota's Board of Investment, and New Jersey's Investment Council give unusually full information on broker-dealer fees.

California State Teachers given the best disclosure on proxy voting.

Arizona Public Safety, New Jersey and Washington State give important details about handling of cash equivalents.

Kansas and Ohio Public Employees have exemplary fullness and clarity of actuarial data.

Indiana State Teachers explain the particular importance of the ratio of accrued service costs to active member payroll, and show this fund's 10-year trend of steadily declining financial strength.

Kentucky Retirement Systems disclosed in 1981 that its outside performance evaluator, comparing this fund to 99 other retirement funds over the 1975–79 period, found Kentucky second worst of the 100.

GODIVA AWARDS FOR OUTSTANDING DISCLOSURE

Just over two years ago, speaking to a consequential group of state retirement fund officials, I gave out awards for good disclosure, and again the following year. Now, my awards could not compete with Oscars, Tonies, etc., unless they had a good name (and maybe not even then?). It was obvious at once that there was only one right name for these Awards to Public Pension Plans for Outstanding Disclosure—The Godiva.

That name, and of course more seriously the recognized importance of effective disclosure, has drawn enough note to the Godivas that New York's Comptroller, Edward V. Regan, sole trustee of the now-$20 billion Common Retirement Fund, reported that Fund's Godiva as a "highlight" on page one of the Fund's Annual Report, see Exhibit 3, attached.

May I use this forum to announce the 1983 Godiva winner, the South Dakota Investment Council's Annual Report.

PENDING NEW VOLUNTARY EFFORT

May I close this discussion of disclosure practices by noting that right now, officials of several state retirement systems—from California, Delaware, District of Columbia, New Jersey, New York, South Dakota, Virginia and Wisconsin and the Ohio Retirement Study Commission—are working to produce models of effective disclosure. We started last May; the ultimate hope is to have models on actuarial and benefits information as well as on investments. While our first product is not yet final (i.e., it has not yet been "signed off" by any of those officials), this effort's first product, an "Investment Results Summary" is Exhibit 4, attached. This summary aims at making possible comparison among similar systems. Without such comparison, evaluation of results is fatally incomplete—and without evaluation of results, accountability is fatally incomplete. The summary aims also at assuring that key data are given, and this is not just an academic ideal of how disclosure should be done: compare the summary and the full South Dakota Investment Council Report.

The effort undertaken by this group is the result of the dedication to responsibility and commitment to excellence of the chairman of Delaware's Board of Pension trustees, Ernst Dannemann.

DISCLOSURE NEEDS BEYOND THE BOTTOM LINE

Investment results—properly considered (1) over a substantial period (certainly not less than three years), and (2) in light of the level of risk assumed, and (3) in comparison with similar funds—give the bottom-line answer to how the assets are being managed. But more detailed disclosure is required (as well, of course, as information about non-investment matters not developed here).

At the 1982 House Hearing, NEA's Linda Tarr-Whelan testified that—

"The association is aware of incursions on retirement system assets by State and municipal governments. Such incursions involve either a misuse of assets or the failure to appropriate required funds to the system. Both practices result in increasing accrued liabilities, which reduces the financial soundness of the system and jeopardizes the security of teacher retirement benefits." (Hearings, at 320)

For one example of a long-standing problem, allocation of broker-dealer business has not lacked for political sensitivity. A few systems, as noted above, carefully disclose all their brokerage, and all systems should so disclose. Many, probably the vast majority of systems, are paying far higher commissions than are needed. One authority has advised me that at a number of major broker-dealer firms, state and local systems are paying average commissions ranging from 17 cents to 33 cents per share. Other major brokers are available to do such business at 7 cents per share (and I am not referring to the new group of "discount" brokers).

Turnover of the portfolio should also be disclosed, although it rarely is. In 1982, one $2.1 billion fund ended its year with $497,000,000 in stocks, having bought during the year $512,000,000 worth and sold $456,000,000 worth. Also, it had $900,000,000 in bonds, having bought $1,578,000,000 worth during the year and sold $1,423,000,000. Its total rate of return for that year was disclosed (1.6 percent to 30 June 1982, not counting mortgages), and it had hired two new managers during that year, but if you were in that State, wouldn't you want to know more?

Troubling turnover is certainly not a norm but equally certainly is not rare enough. Another state fund began 1982 (calendar year) with $479 million in bonds at market value—not counting any short-term holdings—and during that year bought $926 million of bonds and sold or redeemed $774 million; began with stocks worth $282 million, bought $254 million and sold $221 million. That fund gave zero information directly or indirectly explaining such turnover. But it did spend three pages of its annual report on the 6 percent of its portfolio invested in real estate. That fund commendably reported its total return for the year, 23.8 percent, and reported that it used Becker performance evaluation, but failed to report that Becker's median state fund's total return was 29.9 percent for that year. If you were in that State, wouldn't you feel the need to know more?

Another problem, now happily vanished at most major systems, was the practice of leaving significant sums in interest-free checking accounts. In today's era of computers and high interest rates, that gift to the banks has largely ended, but every system should disclose how much (if any) "idle" cash it has.

Recently, we have had the first modern example of how to divert retirement assets away from their purpose in order to grant hidden subsidies to politically notable interests. While I am no idolator of free markets but rather a believer in the need for governmental intervention, including certain subsidies, I know that subsidies will be evaluated far more responsibly in the legislature—which is open, representative, highly accountable—rather than in complex financial transactions at the low-visibility retirement system investment boards. Again, I must turn to "scrappy" South Dakota for the analysis revealing the severity of the problem.

When interest rates were alpine and mortgage money was abysmal, there were acute pressures nationwide to draw retirement assets into mortgages. In 31 states, these pressures were packaged as "in-state targeting," allegedly to aid local homeowners and the construction industry. In only a handful of such States did homeowners get better-than-market rates; in only a few States was new construction aided. But in most of these States, instead of continuing or expanding holdings of in-state-targeted GNMAS or similar established mortgage investments, new kinds of packages were assembled. As the South Dakota analysis found, the new packages were higher risk than alternatives like GNMAS; were also less liquid or completely illiquid; and yet they yielded less than did the established alternatives. South Dakota's analysis (see Exhibit 5) is the backbone and guts [2] of a recent published update by Alicia Munnell, who concluded that the $500 million total of such investments are costing taxpayers and state and local retirement plan participants $10 million per year. While these abuses are being turned around in a few places, like New Hampshire just weeks ago, clearly all retirement systems should be required to disclose any investments made in non-publicly-traded securities; disclose what if any other financial institutions participated in such investments—and if none participated, then should disclose a full explanation of how the terms were set.

---

[2] Albeit without acknowledgement.

Backbone, guts and even language. Compare—South Dakota's:

"Similarly, if the security enjoys a temporary improvement in market value, the investor can realize a profit on the sale. Market liquidity is particularly significant at the present time when interest rates and market values are volatile and the quality of securities issuers is rapidly changing."

And Munnell's:

"Similarly, if the security enjoys a temporary improvement in market value, the investor can realize a profit. Thus, market liquidity has a significant effect on potential rates of return. It has been particularly important in recent years when market interest rates and market values are volatile and the quality of securities issuers is rapidly changing."

Compare also Munnell's Table 6, on state funds' holdings of GNMA's with EBRI's 1979 "Should Pension Assets Be Managed For Social/Political Purposes?", pp. 166, 194-6.

Those targeted mortgage programs carry a special lesson for PEPPRA. In the States participating, laws restricting investments evidently failed to make any discernible difference on whether targetted investments were made. This is a finding from a valuable, indeed pioneering study just released by MFOA's research arm, Government Finance Research Center ("Public Pension Investment Targeting: A Survey of Practices," published in September and the subject of a forthcoming article by Werner Paul Zorn).

Long experience has taught that procrustean investment restrictions do more harm than good, which is why ERISA and more and more States use a prudence standard. But adding more declarations of fiduciary responsibility will do little or nothing if a local system lacks strong professionalism and thus enables ephemeral political pressures to deliver hidden subsidies that avoid clear illegality. Sunlight is the best safeguard.

Last year's opposition to PEPPRA, coming mainly from Texas, was almost exclusively concerned with the fiduciary provisions. Congressman de la Garza's June 8, 1982 letter to Congressman Burton and Erlenborn forwarded the Texas Teachers Retirement System memo listing 10 objections. Their first five objections all dealt with the bills' fiduciary proposals; the sixth dealt with costs, the lesser part of which is disclosure; the seventh protested that the proposed authorization to let the States certify themselves to be in compliance on disclosure, did not cover "the most objectionable features of the legislation", i.e., the fiduciary provisions; the eighth simply urged that a proposed disclosure provision be aligned with ERISA's; the ninth—and this appears a major stumbling block for the Texans—opposed having the fiduciary provisions litigable in federal courts; and the final objection was merely that "it [the bill] is not needed."

The people running the Texas system are professionals. For example, Texas State Teachers participated in the in-state targetted mortgage program—but of 31 such States, only Texas avoided give-aways. These people will not say now, "Last year our opposition centered on the fiduciary provisions, but now that you meet us part of the way, we still oppose the bill because we want it all our way."

May I respectfully submit that if you will reconsider the value of the fiduciary provisions, we can expect the opponents to realize how very easy is compliance with the disclosure provisions, and you will enact this bill. As Texas Pension Review Board Executive Director Rita Horwitz wrote me June 4, 1981, Texas' statewide systems have adequate protection but "many of our local systems do not." [3] Effective disclosure will help all systems and interfere with none.

May I respectfully submit that PEPPRA's promise lies in assuring effective disclosure and thus activating local political processes. I hope the bills will drop the provision allowing States to declare themselves in compliance, since disclosure needs comparability and all States—and Federal taxpayers—will benefit from that. Disclosure is unburdensome, and in return the bills would drop the more burdensome fiduciary provisions which are too likely to give us little new protection but are bound to cause some confusion and much lawyering.

This is my sixth hearing on this legislation. Last year was the Senate's first, this year is the first for Ways and Means. I wouldn't keep returning if I were not steadily more sure, because of my study and efforts in these areas, that the legislation is truly necessary and has virtually no disadvantages. That is, this is as close to a free lunch as one finds. I hope you will soon succeed in enactment, and I will be available to aid you and your staff in any way requested.

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[3] Since I testified, Ms. Horwitz has pointed out to me that after her 1981 letter, Texas law changed to improve the legal protection of local systems, which I am happy to note.

However, disclosure remains dismal. For example, the capitol city of Austin's 1982 Employee Retirement Fund Annual Report notes in its cover letter "an extraordinary year in investment returns"—but (1) nowhere does the report disclose the fund's total return; (2) the reader who persists to page 31 will discover that this fund, with an average balance of $104 million, realized net capital losses of $2,074,975 in contrast to a loss of $39,919 the prior year; and (3) the disclosure of the fund's balance is by methods "not in conformity with . . . generally accepted accounting principles; however, the effect . . . is not material." (p. 32, footnote).

Exhibits

#1 Outstanding disclosure about investment results: South Dakota Investment Council Annual Report for fiscal 1983 (excerpts only)

#2 Impressive disclosure about investment results and investment policy: Ohio State Teachers Retirement System Investment Report for fiscal 1983 (excerpts only)

#3 Draft of forthcoming Model Effective Comparison of Investment Results

#4 South Dakota Investment Council Analysis (May 1982) of 23 "in-State" Mortgage Packages Privately Placed with State and Local Retirement Funds, Oct. 1980-March 1982 (excerpts only)

Exhibit 1

Outstanding Disclosure about Investment Results:

South Dakota Investment Council Annual Report
for Fiscal 1983

South Dakota Retirement System

(1983 Annual Report of S. Dak. Investment Council)

Time Weighted

(As of June

South Dakota Retirement System	Fiscal 1974	Fiscal 1975	Fiscal 1976	Fiscal 1977	Fiscal 1978
Cash Equivalents	9.9%	11.0%	7.3%	6.8%	7.5%
Bond Fund					
Bonds Only	3.1%"1"(1)[1]	14.9%"5"(6)[5]	14.2%"9"(1)[4]	15.9%"1"(5)[5]	0.4%"70"(81)[88]
Equity					
Investment Office Equity Fund					
Investment Office Equity Only	-11.2%"17"(15)[16]	28.9%"1"(8)[1]	16.2%"10"(18)[11]	12.2%"1"(2)[3]	-0.4%"80"(70)[70]
Centennial Cap. Corp/Eagle**	-20.2% [68]	10.0% [63]	6.5% [64]	1.0% [34]	4.8% [35]
Dreman, Grey, Embry					
Bear Stearns					
Northwestern Bank	-14.3% [22]	11.5% [52]	5.6% [71]	-0.4% [71]	0.9% [61]
Total Retirement Fund	-5.9%"35"(38)[10]	15.8%"4"(4)[21]	12.2%"20"(19)[21]	12.9%"28"(15)[3]	1.7%"45"(50)[60]

INDICES

Bond Indices					
Lehman Gov't/Corp. Bond Index	-2.9%	12.7%	10.6%	12.4%	1.0%
Salomon Bond Index	-7.3%	15.0%	10.4%	15.2%	-0.8%
Becker State Bond Median	-4.8%	9.4%	11.8%	15.0%	0.3%
Becker Public Bond Median	-4.9%	9.8%	11.0%	13.6%	0.6%
Becker Total Bond Median	-2.4%	9.9%	10.1%	12.8%	1.5%
Equity Indices					
Dow Jones Ind. Avg	-6.1%	15.7%	19.0%	-4.3%	-5.4%
Standard & Poor's 500	-14.5%	16.1%	14.0%	0.6%	0.0%
Becker State Equity Median	-18.0%	15.9%	9.1%	-2.9%	1.6%
Becker Public Equity Median	-17.7%	15.6%	9.1%	-2.7%	2.4%
Becker Total Equity Median	-19.1%	13.7%	7.9%	-2.6%	2.3%
Total Fund Indices					
Becker State Universe Median	-6.0%	10.9%	11.4%	10.4%	1.5%
Becker Public Universe Median	-7.4%	11.2%	10.4%	7.6%	1.7%
Becker Total Universe Median	-12.1%	11.8%	9.5%	3.6%	2.1%
Consumer Price Index	10.9%	9.3%	5.9%	6.9%	7.4%

* See notes page 53.

Rates Of Return* — footnotes on next page

30, 1983)

Fiscal 1979	Fiscal 1980	Fiscal 1981	Fiscal 1982	Fiscal 1983
8.5%	11.8%	10.0%	15.8%	12.0%
			11.1% [61]	29.8% [31]
8.3%"6"(4)[24]	2.2%"22"(41)[62]	- 8.1%"20"(53)[67]	11.0%"50"(44)[60]	33.7%"52"(38)[23]
			- 4.1% [21]	59.0% [47]
14.4%"18"(33)[36]	8.8%"90"(90)[94]	27.6%"17"(17)[33]	- 9.0%"25"(26)[24]	79.1%"1"(10)[17]
11.8% [52]	17.5% [49]	25.2% [43]	-13.1% [73]	59.5% [46]
			- 9.1% [48]	65.5% [27]
7.0%*			17.3% [1]	68.3% [23]
9.8%"8"(25)[58]	7.6%"20"(56)[84]	8.8%"4"(30)[70]	1.8%"80"(72)[31]	44.2%"8"(17)[49]
7.7%	3.8%	- 4.1%	13.4%	29.1%
7.2%	- 2.4%	13.0%	8.7%	42.4%
7.0%	0.3%	- 9.8%	11.1%	34.6%
6.7%	1.6%	- 7.9%	10.4%	32.3%
7.4%	3.5%	- 6.3%	11.7%	29.0%
9.2%	9.7%	19.3%	-11.4%	58.7%
13.7%	17.1%	20.4%	-11.7%	61.2%
11.7%	16.5%	19.9%	-10.9%	61.9%
12.1%	16.5%	21.4%	-11.6%	64.2%
13.0%	17.2%	23.8%	-13.2%	66.0%
8.0%	5.2%	1.0%	6.3%	39.8%
8.3%	8.1%	3.1%	4.1%	37.6%
10.4%	11.4%	12.1%	- 1.0%	44.1%
10.9%	14.3%	9.6%	7.1%	2.6%

Notes To Time Weighted Rates Of Return For The South Dakota Retirement Fund And Cement Plant Retirement Fund

Numbers in " " indicate ranking against Becker State Fund Universe which includes 38 states
( ) indicate ranking against Becker Public Fund Universe which include 450 public funds
[ ] indicates rankings against Becker Total Fund Universe which includes over 4500 funds

** Returns quoted for Fiscal Years 74, 75, 76 and 77 were earned by Centennial Capital Corporation. Returns for each year since have been earned by Eagle Management and Trust.

Prior to July 1, 1981, the Retirement Funds were measured on an equity only, bonds only basis. Due to computer capabilities, effective July 1, 1981, the Retirement Funds were divided into two mutual funds containing both cash and financial assets. This enabled the managers to know their cash exposure at all times.

A. G. Becker does not calculate performance for the Cement Plant Retirement Fund. Performance for this fund is calculated internally and the results are ranked against the various A. G. Becker Universes.

The S&P 400 is composed entirely of industrial companies. The S&P 500 is composed of the industrial companies of the S&P 400 plus an additional 100 companies selected from among the transportation, banking, insurance and finance; and electric, telephone and natural gas utility industries.

The inclusion of utilities in itself would tend to increase debt-to-equity ratios while the financial leverage of banks and similar financial companies makes meaningful balance sheet comparisons difficult. Utilities and financial stocks tend to have higher dividend yields, sell at lower price earnings ratios and price-to-book value ratios, and particularly over the course of a business cycle, utilities in theory should earn a lower return on equity than unregulated industrial companies. As a consequence, the S&P 500 will yield more than the S&P 400, sell at a lower P/E ratio, and a lower price-to-book ratio than the S&P 400. The differences in yield and the ratios will be minor because the S&P 400 industrials dominate the S&P 500.

Time Weighted Annualized

(As of June

South Dakota Retirement System	Fiscal 1974-83	Fiscal 1975-83	Fiscal 1976-83	Fiscal 1977-83	Fiscal 1978-83
Cash Equivalents	10.0%	10.0%	9.9%	10.3%	10.9%
Bond Fund					
Bonds Only	9.0%"1"(1)[1]	9.6%"14"(1)[14]	9.0%"18"(11)[30]	8.2%"24"(19)[52]	7 0%"24"(28)[66]
Equity					
Investment Office Equity Fund					
Investment Office Equity Only	14.4%"1"(1)[10]	17.7%"1"(1)[12]	16.4%"1"(1)[17]	16 4%"1"(6)[21]	17.1%"5"(17)[36]
Centennial Cap. Corp/Eagle**					15 6% [56]
Dreman, Grey, Embry					
Bear Stearns					
Northwestern Bank					
Total Retirement Fund	10.2%"1"(7)[17]	12.2%"1"(1)[22]	11 7%"1"(3)[32]	11.7%"1"(9)[40]	11.5%"1"(23)[72]
INDICES					
Bond Indices					
Lehman Gov't/Corp. Bond Index	8.0%	9.3%	8.9%	8.6%	8.0%
Salomon Bond Index	6.5%	8.1%	7.4%	7.0%	5.7%
Becker State Bond Median	6.8%	8.1%	8.0%	7.3%	6.7%
Becker Public Bond Median	6.6%	8.2%	8.2%	7.7%	6.8%
Becker Total Bond Median	7.4%	8.5%	8.5%	8.3%	7.6%
Equity Indices					
Dow Jones Ind. Avg.	8.9%	10.7%	10.1%	8.9%	11.3%
Standard & Poor's 500	10.0%	13.1%	12.8%	12 6%	14 7%
Becker State Equity Median	8.9%	12.7%	12.2%	12.5%	15.4%
Becker Public Equity Median	9.1%	12.7%	12.3%	13.1%	15.9%
Becker Total Equity Median	9 2%	13.1%	12.8%	13.2%	15.8%
Total Fund indices					
Becker State Universe Median	7.3%	9.4%	9.2%	8.9%	9.2%
Becker Public Universe Median	7.7%	9.7%	9.4%	9.3%	9.9%
Becker Total Universe Median	8.5%	11.1%	11.0%	11 2%	12.5%
Consumer Price Index	8.4%	8.2%	8.0%	8.3%	8.6%

* See notes page 53.

Rates of Return* ([illegible])

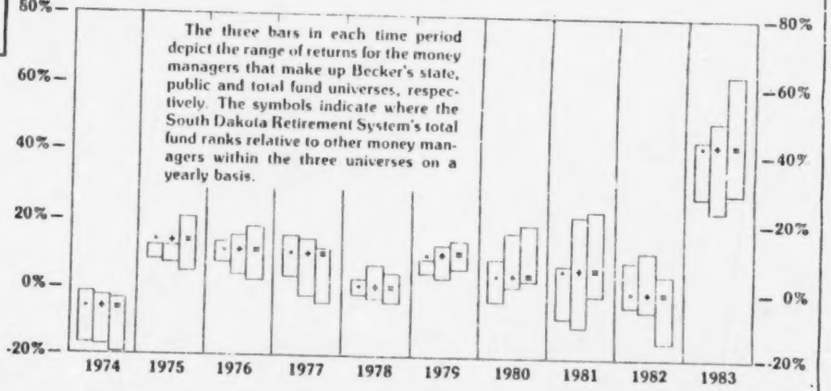
30, 1983)

Fiscal 1979-83	Fiscal 1980-83	Fiscal 1981-83	Fiscal 1982-83	Fiscal 1983
11.6%	12.4%	12.6%	13.9%	12.0%
			20.1% [39]	29.8% [31]
8.6%"17"(19)[59]	8.6%"26"(38)[66]	10.9%"38"(46)[60]	21.8%"56"(45)[24]	33.7%"52"(38)[23]
			23.5% [28]	59.0% [47]
21.0%"3"(14)[28]	22.6%"3"(14)[28]	27.6%"1"(3)[14]	27.7%"1"(2)[12]	79.1%"1"(10)[17]
17.9% [64]	19.5% [56]	20.1% [65]	17.7% [74]	59.5% [46]
			22.7% [34]	65.5% [27]
			40.5% [1]	68.3% [23]
13.5%"5"(23)[71]	14.5%"1"(24)[67]	16.9%"1"(20)[52]	21.1%"24"(34)[34]	44.2%"8"(17)[49]
9.4%	9.9%	12.0%	21.0%	29.1%
7.1%	7.1%	10.4%	24.4%	42.4%
8.0%	8.2%	10.6%	22.6%	34.6%
8.1%	8.4%	10.8%	21.6%	32.3%
8.9%	9.5%	11.3%	20.2%	29.0%
15.0%	16.5%	18.8%	18.6%	58.7%
18.0%	19.0%	19.7%	19.3%	61.2%
18.4%	19.7%	20.8%	20.4%	61.9%
18.6%	20.5%	21.7%	20.3%	64.2%
18.8%	19.9%	21.2%	20.4%	66.0%
10.7%	11.5%	13.6%	20.4%	39.8%
11.2%	12.1%	13.6%	20.5%	37.6%
14.9%	15.8%	17.0%	19.8%	44.1%
8.8%	8.3%	6.4%	4.8%	2.6%

The South Dakota Retirement System's total fund (equities, bonds, and cash reserves for SDRS's managers combined) returned 44.2% for fiscal 1983 placing it in the 8th, 17th, 49th percentile ranking of the Becker State, Public and Total Universe, respectively.

Total Fund: Rates of Return

Becker State, Public & Total Fund Comparisons
(As of June 30, 1983)



The three bars in each time period depict the range of returns for the money managers that make up Becker's state, public and total fund universes, respectively. The symbols indicate where the South Dakota Retirement System's total fund ranks relative to other money managers within the three universes on a yearly basis.

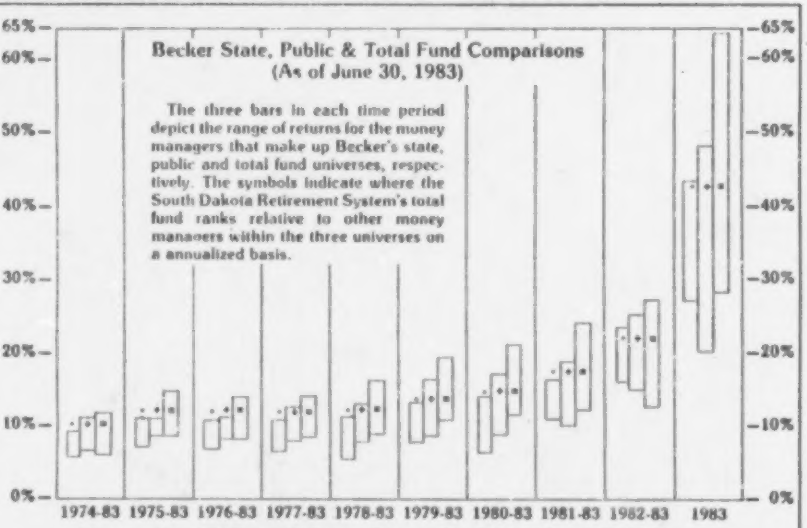
Bars Represent The Range Of Returns Between The Fifth and Ninety-Fifth Percentile.

Percentile Rankings

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
State Universe (•)	35	4	20	28	45	8	20	4	80	8
Public Universe (+)	38	4	19	15	50	25	56	30	72	17
Total Universe (=)	10	21	21	3	60	58	84	70	31	49
South Dakota Retirement Fund	-5.9%	15.8%	12.2%	12.9%	1.7%	9.8%	7.6%	8.8%	1.8%	41.2%

The South Dakota Retirement System's total fund (equities, bonds, and cash reserves for SDRS managers combined) returned 44.2% for fiscal 1983 placing it in the 8th, 17th, 49th percentile ranking of the Becker State, Public and Total Universe, respectively.

Total Fund: Annualized Rates of Return



Becker State, Public & Total Fund Comparisons
(As of June 30, 1983)

The three bars in each time period depict the range of returns for the money managers that make up Becker's state, public and total fund universes, respectively. The symbols indicate where the South Dakota Retirement System's total fund ranks relative to other money managers within the three universes on a annualized basis.

Bars Represent The Range Of Returns Between The Fifth and Ninety-Fifth Percentile.

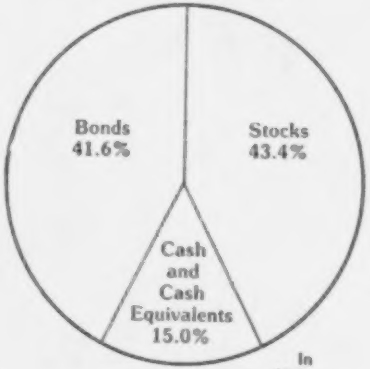
Percentile Rankings

	1974-83	1975-83	1976-83	1977-83	1978-83	1979-83	1980-83	1981-83	1982-83	1983
State Universe (*)	1	1	1	1	1	5	1	1	24	8
Public Universe (+)	7	1	3	9	23	23	24	20	34	17
Total Universe (=)	17	22	32	10	72	71	67	52	34	49
South Dakota Retirement Fund	10.2%	12.2%	11.7%	11.7%	11.5%	13.5%	14.5%	16.9%	21.1%	44.2%

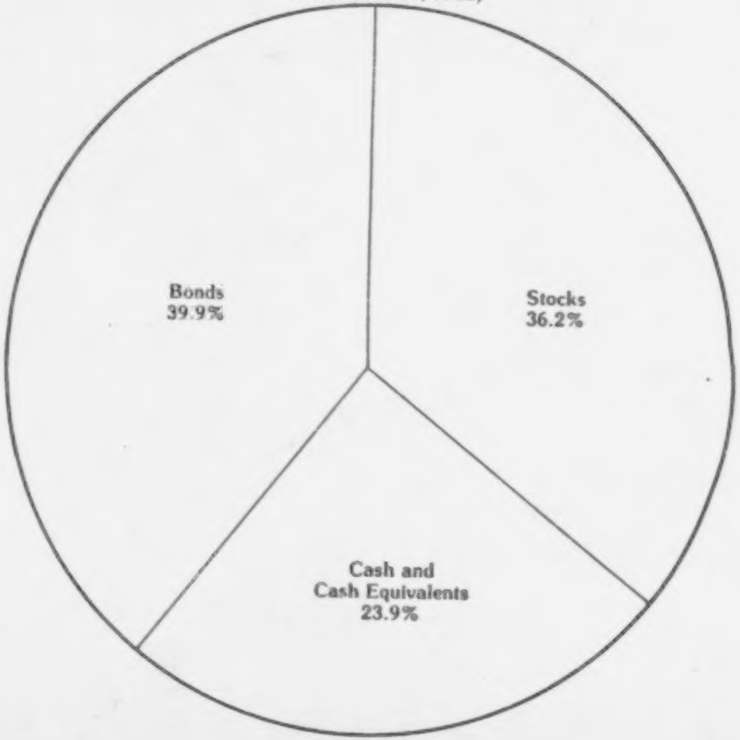
The two pie charts show the mix in the South Dakota Retirement Fund's investments as of June 30, 1982 and June 30, 1983.

Investment Mix: By Instrument

(As of June 30, 1982)



(As of June 30, 1983)



	In Millions 1982	1983
Bonds	$133.4	$195.9
Common Stock	139.2	177.8
Cash/Cash Equiv.	48.3	117.1
	$320.9	$490.8

A breakdown of the investment mix into industries shows Utilities, Finance, and Capital Goods as the major stock investments with U.S. Government Bonds the major fixed income holding.

Investment Mix: By Industry

(As of June 30, 1983)

	Market		Percentage of Portfolio		Percentage Change from 1982
Bonds					
U.S. Government	$195,508,568		39.84%		
Corporates	100,000		.02%		
Private Placements	219,111	$195,827,679	.04%	39.90%	-1.67%
Common Stock					
Manufac-Processing	$ 11,718,588		2.39%		
Capital Goods	26,268,350		5.35%		
Petroleum	18,421,607		3.75%		
General Business	12,479,188		2.54%		
Transportation	2,660,213		.54%		
Consumer-Basic	12,979,151		2.64%		
Consumer-Discretion	14,963,878		3.05%		
Finance	29,232,273		5.96%		
Shelter	1,542,200		.31%		
Utilities	40,611,504		8.28%		
Liquidation	5,731,587		1.17%		
Risk Aritrage	1,211,154	$177,819,693	.25%	36.23%	-7.16%
Cash and Cash Equivalents	$117,124,902	117,124,902	23.87%	23.87%	+8.83%
Total		$490,772,274		100.00%	

Equity Profile

(As of June 30, 1983)

Portfolio Characteristics

	S&P 500	SDRS Total Fund	Investment Office	Eagle Management	Dreman Gray & Embry	Bear** Stearns
Price/Earnings Ratio	12.8	9.1	8.8	14.7	8.9	N/A
Dividend Yield	4.3%	5.6%	5.8%	2.6%	4.6%	N/A
Return on Equity	13.5%*	12.4%	12.3%	14.5%	11.4%	N/A
Price/Book Value Ratio	1.5*	1.3	1.2	2.3	1.1	N/A
Beta	1.0	.97	96	1.2	1.1	N/A
R-squared	1.0	.94	.94	.93	.94	N/A
Number of Issues	500	182	64	54	37	27

Ten Largest Holdings

	Percent Of Equity Portfolio
American Tel & Tel	3.32%
International Bus. Machines	3.03%
GTE Corp.	2.00%
International Tel & Teleg	1.78%
Tenneco Inc.	1.69%
Exxon Corp.	1.60%
General Elec. Co.	1.50%
Aetna Life & Cas. Co.	1.46%
SRI Corp. NJ Comm.	1.40%
Greyhound Corp.	1.38%
TOTAL	19.16%

Distribution by Market Sector

	SDRS Total Fund	S&P 500
Manufac-Processing	4.6%	7.1%
Capital Goods	10.4%	19.0%
Petroleum	7.2%	16.4%
General Business	4.9%	7.4%
Transportation	1.1%	2.2%
Consumer-Basic	5.1%	12.9%
Consumer-Discretion	5.9%	14.2%
Finance	11.5%	7.0%
Shelter	.6%	1.9%
Utilities	16.0%	11.9%
Liquidation	2.3%	0.0%
Risk Arbitrage	.5%	0.0%
Cash Equivalents	29.9%	0.0%
TOTAL	100.0%	100.0%

*Apply to S&P 400, see note on page 53.

**Many of the characteristics do not apply due to the uniqueness of Bear Stearns holdings.

Equity Profile History

The South Dakota Retirement Fund's equity portfolio characteristics for the 9 years since consolidation are presented below.

The seven characteristics are presented for each manager and the S&P 500 for comparative purposes.

	1975	1976	1977	1978	1979	1980	1981	1982	1983
Investment Office									
Price/Earnings Ratio	9.0	9.2	8.4	7.3	7.5	7.3	8.2	6.0	8.8
Dividend Yield	6.5%	6.2%	6.3%	6.5%	6.1%	6.2%	6.1%	7.2%	5.8%
Return on Equity	11.9%	13.0%	13.9%	14.4%	15.3%	14.3%	13.8%	13.2%	12.3%
Price/Book Value Ratio	1.2	1.3	1.2	1.2	1.2	1.1	1.1	.91	1.2
Beta	.94	.97	1.01	1.04	1.04	1.03	1.04	1.02	.96
R squared	.89	.91	.90	.92	.96	.96	.96	.96	.94
Number of Issues	34	44	50	45	80	66	65	71	64
Centennial Capital ('75-'77)/Eagle Management & Trust ('78-'83)									
Price/Earnings Ratio	12.9	11.9	8.7	7.5	7.3	8.5	9.9	8.5	14.7
Dividend Yield	4.6%	4.1%	4.6%	5.0%	5.0%	4.4%	3.7%	5.0%	2.6%
Return on Equity	12.3%	13.3%	13.5%	14.3%	14.9%	16.1%	16.0%	15.2%	14.5%
Price/Book Value Ratio	2.0	1.8	1.6	1.3	1.3	1.6	1.7	1.6	2.3
Beta	1.1	1.1	1.2	1.1	1.0	1.1	1.2	1.1	1.2
R-squared	.95	.96	.93	.94	.95	.91	.90	.96	.93
Number of Issues	44	43	33	42	44	55	59	63	54
Northwestern Bank ('75-'78)/Dreman, Grey & Embry ('82-'83)									
Price/Earnings Ratio	14.5	11.5	10.4	9.1				6.7	8.9
Dividend Yield	5.7%	5.3%	5.6%	5.1%				6.5%	4.6%
Return on Equity	16.7%	15.8%	14.5%	17.2%				12.1%	11.4%
Price/Book Value Ratio	2.6	2.8	1.7	1.7				.9	1.1
Beta	.92	.97	1.03	1.07				1.1	1.1
R-squared	.87	.94	.94	.96				.96	.94
Number of Issues	23	24	42	65				34	37
S&P 500									
Price/Earnings Ratio	12.0	11.3	9.6	8.5	7.4	7.7	8.7	7.7	12.8
Dividend Yield	3.9%	3.6%	4.3%	5.1%	5.2%	5.2%	4.9%	6.2%	4.3%
*Return on Equity	12.5%	14.0%	13.9%	14.6%	16.5%	14.9%	14.4%	11.1%	13.5%
*Price/Book Value Ratio	1.6	1.7	1.5	1.3	1.2	1.3	1.4	1.1	1.5
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
R-squared	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Number of Issues	500	500	500	500	500	500	500	500	500

*Apply to S&P 400, see note on page 53.

Portfolio Characteristics

	SDRS Bonds Only	SDRS Total Fund*
Number of Issues	14	24
Average Coupon	10.27%	10.36%
Yield to Maturity	11.00%	11.00%
Average Maturity	11.79 Yr.	9.98 Yr.
Duration	6.14 Yr.	5.19 Yr.
Average Quality	4.0	4.0

(AAA = 4, AA = 3, A = 2, BAA = 1)

Bond Profile

(As of June 30, 1983)

Distribution By Maturity	%
Short-Term Cash Equiv	17.4%
1 to 5 Years	23.6%
5 to 10 Years	2.0%
10 to 15 Years	26.1%
15 to 20 Years	30.9%
TOTAL	100.0%

Distribution By Issue	%
Short-Term Cash Equiv.	17.4%
U.S. Government	77.8%
Pass Throughs	4.6%
Utilities	.1%
Finance	.1%
TOTAL	100.0%

Distribution By Quality Rating	%
Short-Term Cash Equiv.	17.4%
AAA	82.5%
AA	.1%
TOTAL	100.0%

Distribution By Coupon	%
Short-Term Cash Equiv.	17.4%
7.1% - 8%	11.2%
8.1% - 10%	15.5%
10.1% - 11%	36.9%
11.1% and Over	19.0%
TOTAL	100.0%

*Includes Bonds and Cash Equivalents

Bond Profile History

The South Dakota Retirement Fund's bond portfolio characteristics for the 9 years since consolidation are presented below. The numbers apply to only the bonds in the portfolio, with the exception of cash equivalent which state the cash portion in the total bond portfolio.

	1975	1976	1977	1978	1979	1980	1981	1982	1983
Number of Issues	120	107	30	21	18	18	17	18	14
Average Coupon	9.30%	8.76%	8.24%	7.90%	7.93%	8.96%	10.37%	11.61%	10.27%
Yield to Maturity	9.38%	8.54%	8.07%	8.75%	8.85%	10.41%	13.58%	14.23%	11.00%
Average Maturity	19.14 yr.	14.77 yr.	17.20 yr.	16.42 yr.	17.25 yr.	17.49 yr.	14.21 yr.	12.39 yr.	11.79 yr.
Duration	7.83 yr.	6.89 yr.	8.15 yr.	8.91 yr.	8.57 yr.	8.00 yr.	6.35 yr.	5.63 yr.	6.14 yr.
Average Quality*	2.39	2.92	3.46	3.72	3.93	3.91	4.00	4.00	4.00
Cash Equivalent	3.1%	1.4%	11.9%	24.5%	20.9%	23.5%	12.0%	15.7%	17.4%

*(AAA = 4, AA = 3, A = 2, BAA = 1)

Exhibit 2

Impressive Disclosure about Investment Results and Investment Policy

Ohio State Teachers Retirement System,
Investment Report for Fiscal 1983

THE STATE TEACHERS
RETIREMENT SYSTEM OF OHIO

275 EAST BROAD STREET • COLUMBUS 43215
TELEPHONE 227-4090
AREA CODE 614

1983
Investment
Report

Dear Member:

Benefits of the State Teachers Retirement System are funded primarily by teacher contributions, employer contributions, and investment income. In 1970 investment income contributed approximately 24% toward funding of benefits. By 1983 this increased to more than 45% of the amount reserved to pay benefits. Investment income now represents the single greatest income source for providing benefits to 53,000 retirees and future payments to 220,000 current members. Net investment income exceeded $670 million in fiscal year 1983.

Unlike the previous three fiscal years, in 1983 both the fixed income and stock markets gained continued upward momentum to attain record high levels. A careful review of this investment report will reveal that our ending market value of $7.75 billion exceeds our beginning market value, adjusted for receipt of new investable funds, by $1.4 billion. As always, this report lists both cost and market value for each specific issue and for the aggregate portfolio.

Recent STRS equity participation in real estate continues to be a successful form of investment diversification for the portfolio and now constitutes 14.1% of total fund market value.

It is important to keep in mind that the investment authority for the State Teachers Retirement System is governed by Section 3307.15 of the Ohio Revised Code, and more specifically by the State Teachers Retirement Board's Investment Objective and Policy statement. Neither of these items required major revision during fiscal year 1983, although the STRS staff did implement a refined and timely performance update for the Board to monitor performance with its established guidelines.

Finally, in 1983 the State Teachers Retirement Board initiated a "three-phase plan" to reduce its actuarial funding period from 59 years to 40 years. This will stabilize the long-term funding deficiency created by benefit changes over the past ten years and assure responsible funding for future benefits. Net investment income, which increased more than 30%, is a major step toward fulfilling this obligation.

Sincerely,

C. James Grothaus
Executive Director

Investment Review

Inc

In fiscal 1983, more milestones were passed by The State Teachers Retirement System of Ohio. Investment assets surpassed the $7 billion mark and net investment income exceeded $670 million. Total assets increased from $6.3 billion to $7.2 billion at cost, while the market value of the portfolio rose dramatically from $5.6 billion to $7.8 billion.

The past twelve months have produced a rather dramatic turnaround in the American economy and in its financial markets. We began our fiscal year in the depths of what was, in many respects, the worst recession of the postwar period. but ended it with very rapid growth in real Gross National Product in the second quarter of 1983. Some analysts even feared that growth had become too rapid. The transition began late in the summer of 1982 when the Federal Reserve Board eased the availability of credit and interest rates started a drop that lasted until May of 1983. The first sector to respond to the lower interest rates was new home construction. By December of 1982, the growth in housing had been joined by an upturn in consumer purchases of durable goods to generate an economic recovery. The first quarter of 1983 showed modest growth. but the second quarter shot ahead at a 9.7% rate, carried mostly by consumer spending for durable goods. There was good news for workers, as more than 1.7 million jobs were gained back, disposable personal income grew at an 8.6% rate, and inflation remained very cool. This recovery appears to have sufficient momentum to carry into 1984, but there are a few clouds on the horizon. Interest rates have been rising since late in the second quarter as credit market participants retreated in anticipation of a coming clash between private borrowers and the huge credit appetite of the U.S. Treasury. The failure of Congress and the Administration to come to grips with budget deficits in the area of $200 billion has been a major disappointment. Until and unless this drain on credit is reduced significantly, the most we can hope for is a recovery that struggles along at a very modest pace.

There has been tremendous improvement in the money and capital markets over the course of the fiscal year just ended. Even with the retreat experienced in May and June, prices on debt and equity securities ended the year strongly on the plus side.

Most of the decline in interest rates (which produces an increase in bond prices) occurred in the first half of our fiscal year. This was followed by a period of relative stability until May when interest rates began to rise. In the short-term sector, 3 month Treasury Bills began the year at 12.5%, fell to 7.0% by September, and then traded between 7% - 8% until they started a rise in May which reached 8.8% at year-end. In the long-term sector, 30 year Treasury bond yields started at 14.0%, fell to 10.2%, and ended at 11.0%, while long AAA rated corporate bond yields fell from 15.3% to 10.6% before ending the year at 11.6%.

Improved quality and reduced market volatility continue to be major objectives of the STRS bond portfolio. On a scale where AAA = 1 and AA = 2, quality was improved from 1.42 to 1.17 over the course of the fiscal year just ended. Reduced volatility was achieved by reducing the average maturity, excluding cash, from 14.3 years to 11.3 years and the duration of the portfolio from 5.6 years to 5.2 years. Cash reserves were almost unchanged at 7.0% of the bond portfolio, versus 6.7% a year ago. Table III describes our bond portfolio in summary form.

When equity investors observed these declines in interest rates in a context of slowing inflation and improved chances of economic recovery, they were able to conclude that stock prices were too low. This conclusion led to an explosion in equity market trading volume and produced stock prices gains that were simply spectacular. Over the past twelve months, the Dow Jones Industrial Average rose 50.5%, while the Standard & Poor's 500 Index did even better, advancing 53.4%.

Review of Investment Objective and Policy

You may recall that the State Teachers Retirement Board made extensive changes in its Investment Objective and Policy statement in fiscal 1982 to incorporate the increased investment authority granted to STRS by legislation passed that year. That revision in the Board's eight year old Policy affected all major asset classes, but its most significant modifications were in real estate, common stock, and venture capital investments. In fiscal 1983 the revisions in the Policy were much more modest and they dealt primarily with refinements in overall risk levels, return levels, and performance measurement. The following paragraphs highlight only those changes in the Policy since last year. For a complete review of the STRS guidelines for the management of investment assets, please refer to the Investment Objective and Policy statement printed on pages 22 through 31.

Since its inception, the Policy statement has prescribed overall risk limits for the total fund and its major components. The Board has always desired to have a total portfolio that is less risky than the overall financial market. However, with the extreme fluctuations in interest rates over the past three years, the market volatility of fixed income investments has increased significantly. The revised policy reflects this increased volatility in all fixed income investments and it was supported by research from our outside investment consultant. By policy, the total fund remains less volatile than the market as a whole.

An additional refinement made in fiscal 1983 was to slightly increase the total return objective of the entire fund. In today's investment environment, it appears that a return objective of 9-10% per year over a long time horizon is achieveable given the level of risk acceptable for the STRS fund. This objective was increased by 1% over the previous objective mainly due to the higher returns available longer term in fixed income investments. This long-term goal for STRS assets is monitored continually by the Board and it is changed to reflect the overall desired risk levels of the fund.

To insure the optimum management of STRS assets, the Board Policy has always had relative performance standards for major sectors of the portfolio. In the past year, the Board reviewed those relative yardsticks and made some minor changes. In addition, the investment staff developed a monthly reporting system for the Board to keep them properly advised on the progress of the fund. This should not be interpreted to mean that performance for an individual month takes on special meaning. Returns over extended periods remain our principal focus. Performance measurement is computed on a calendar basis (December 31) rather than our normal fiscal year (June 30) basis because most comparisons in the investment universe utilize a December year end. The chart below is an excerpt from our Performance Report indicating the performance of the Equity Portfolio, Fixed Income Portfolio, and Total Fund relative to our yardsticks for the time periods set forth in the Policy statement. While the details of performance can be examined by each reader, STRS portfolios in general have matched or exceeded the respective relative targets nearly 70% of the time.

	1 Year 1982	2 Years 1981-1982	3 Years 1980-1982
Equities			
STRS Common Stocks	23.3%	9.2%	15.1%
Criteria List	24.3%	15.4%	NA
Standard & Poor's 500	21.5%	4.8%	15.1%
Dow Jones Industrials	27.2%	7.4%	14.4%
Becker Median Fund	21.9%	8.0%	15.4%
Fixed Income			
STRS Bonds + Cash	39.5%	23.0%	12.4%
Lehman K-L Bond Index	31.1%	18.5%	13.2%
Total Fund			
STRS	30.1%	14.7%	12.5%
SP 500/LBKL Hybrid Index	26.0%	14.8%	14.2%
Inflation	4.4%	6.6%	7.8%

GNP deflator, see p. 31

Published As Provided For By Section 3307.15 of the Ohio Revised Code

INVESTMENT OBJECTIVE AND POLICY

The System is governed by a Board of nine members with broad statutory powers. The investment function is vested in the Board as set forth in Section 3307.15 of the Ohio Revised Code. Section 3307.15 of the Ohio Revised Code requires the Board to "...adopt in regular meeting, policies, objectives or criteria for the operation of the investment program. Amendments and additions to the policy shall be adopted in regular meeting... ." These policies and regulations are adopted under that authority.

In addition to the investment function, Section 3307.15 of the Ohio Revised Code also sets forth the fiduciary responsibility of the Board and other fiduciaries in discharging their duties with respect to the fund. Section 3307.01 (U) of the Ohio Revised Code defines a fiduciary, and Section 3307.14 of the Ohio Revised Code lists specific items a fiduciary shall and shall not do. This objective and policy statement incorporates and is subject to all of the above mentioned sections of the Ohio Revised Code.

LIQUIDITY NEEDS

It is anticipated that contributions to the pension fund will exceed disbursements for the foreseeable future. Therefore, there is no special need for liquidity in the portfolio, other than that deemed necessary for the accomplishment of investment objectives and strategies.

PRESERVATION OF CAPITAL

In many if not most instances payments from the pension fund constitute the major sources of income to retirees and a principal protection against the contingencies of death and disability for active workers. Therefore, the basic policy of the Board is preservation of the capital investment together with realization of sufficient return to secure and facilitate payment of the statutory benefit requirements of the System to its beneficiaries. In this connection, it is recognized that the fund will achieve some protection against erosion of principal value through inflation, if the 7.5% interest rate assumption is achieved.

The risk level of the pension fund should be considerably less than that of the stock market as a whole but may be somewhat more than that of the bond market by itself. Using volatility as a proxy for risk, and assuming that the volatility level of the stock market (defined to be the Standard & Poor's "500" Average) is 1.0, the bond market approximately 0.6, and short term cash reserves zero, a volatility level of about 0.8 is considered acceptable for the fund as a whole. This means that, in a downward stock market, the total pension fund should not fall by more than 80% of the decline in the stock market. This should protect the beneficiaries from any undue risk.

In terms of the stock sector alone, restricted by statute to 35% of the fund, a volatility level of between 1.0 and 1.15 (from equality with the stock market to a level 15% higher) is acceptable. Under normal circumstances, the volatility level of the stock sector should average slightly above 1.0. The publicly traded bond sector of the portfolio should have a volatility level approximately that of the Lehman Brothers Kuhn Loeb Government/Corporate Bond Index.

TOTAL RETURN

Each 1% increase in investment return will finance benefit improvements in the range of 10%-15%, or will allow a similar reduction in contributions. Such gain may also be used to improve the actuarial condition of the plan. Therefore, maximization of return, both from current income and capital appreciation consistent with the overall risk parameters described above, is an important objective. Within the confines of strict adherence to the statutory investment limitations and restrictions, the Board desires to set a total return objective of 9%-10% per annum. This is to be viewed as a long-term (five to ten year) objective, and this total return objective, as well as other return objectives, is based on an assumed long-term inflation rate of 7%. The objectives should be pursued consistently with prudent management and at the minimal level of market risk necessary to accomplish it.

This fund does not have a capital return or income return objective separate from the total return objective. However, it is anticipated for the total account that there will be income yield over a long-term period which is greater than capital growth, because of the preponderance of fixed income assets.

For the publicly traded bond sector of the portfolio, a total return objective of 8%-10%, averaged over a period of five to ten years, is desired. Should conditions change in the bond market so as to make this objective unattainable without undue risk, it will be the responsibility of the Investment Advisor to recommend to the Board a revised figure. Undue risks are to be avoided, particularly those of lower-than-average quality (an average rating of between A and Aa should be maintained in the publicly traded sector of the bond portfolio, considering U.S. Treasury and agency obligations as Aaa).

For the equity sector of the portfolio, a total return objective of 10%-12%, averaged over a period of five to ten years, is desired. Should the Investment Advisor believe that attainment of this objective at anytime is not possible without undue risk, it is his responsibility to recommend to the Board a revised figure. In today's market, the Board believes that a 10%-12% objective is realistic, within the volatility guidelines expressed above. The Board recognizes that there is a level of risk associated with a 10%-12% total equity return objective, which should be achieved, however, with the minimum risk acceptance necessary. That is to say, total return should be maximized at the accepted level of risk. The equity portfolio should minimize non-market risk by being highly diversified.

Income is expected to be an important part of total return, not only for the portfolio as a whole but for the equity sector. Growth of income should be an important objective, particularly in the equity sector.

GEORGETOWN UNIVERSITY LAW CENTER
WASHINGTON, D. C. 20001

ROY A. SCHOTLAND
PROFESSOR OF LAW

Exhibit 3: Effective Comparison of Investment Results

NEA Retirement Forum November 1983

Investment Results Summary

Attached is the first product of several State Retirement Funds' effort to improve the availability and comparability of information about such funds. In May, officials of state funds from California, Delaware, District of Columbia, New Jersey, New York, South Dakota, Virginia and Wisconsin, as well as the Ohio Retirement Study Commission and two leading actuarial authorities participated in beginning this. Two of these States are already beginning to include in their annual reports such summary information.

The attached of course will evolve and enjoy improvement. And this is only our *first* product: the plan is to treat not only investment data, but also actuarial and benefits information.

Your reactions--and support!--would be most welcome.

(for all[!] state retirement funds) (Schotland, 21 October)

INVESTMENT RESULTS SUMMARY*1

(To June 30, 1983)

	1979	1980	1981	1982	1983	5 years 1979-83	10 years 1973-83
	(Annual Rates)					(Average Annualized)	
1. Total return, time-weighted (see glossary):							
a) The Fund:*2							
b) Some other "index/indexes" of comparable retirement funds*3:							
c) CPI:							
d) Relative riskiness:*4 (standard deviation)							
--The Fund:							
--Index(es) of comparable funds:							
2. Asset allocation percentages							
a) Equities:							
b) Fixed-income:							
c) Short-term:							
d) Other*5 (unless totalling under 2% of Fund)							
i] Mortgages not readily priced:							
ii] Any other fixed-income not included in item b) above:							
iii] Equity real estate:							
iv] Guaranteed investment contracts:							
v] Other:							

[*1 Footnotes follow →]

3. Equity returns[*6]

a) The Fund:

b) S&P 500[*7]:

c) Possible additional index(es):

d) Comparable retirement funds:

e) Relative riskiness:
--The Fund's...
...beta:
[and/or]
...standard deviation:

--Index(es) of
comparable funds'...
...beta:
[and/or]
...standard deviation:

4. Fixed-income (at market value) (does not include short-term) returns[*8]:

a) The Fund's:

b) LBKL Govt./Corp. Bonds:

c) Possible additional index(es)[*9]

d) Comparable retirement funds:

e) Relativa riskiness:

--The Fund's...
...average quality:

...average maturity:

...average coupon:

...yield to maturity:

...duration (if
available):

--Index(es) of
comparable funds'...
...average quality:

...average maturity:

...average coupon:

...yield to maturity:

...duration:

5. Short-term returns*10

a) The Fund:

b) Treasury bills:

c) Comparable retirement funds:

* FOOTNOTES

1/ This summary must be read in light of the full context: the fuller investment data and the investment objectives [and statutory limits on permissible investments]. While comparing The Fund's results to market indexes or other funds' results can be illuminating, it can be confusing and even misleading if the full context is not considered. Our commitment to full disclosure rests on the belief that The Fund will be more successful if our state officials, taxpayers and Fund participants have the information to understand what The Fund does and how well it does.

The Fund's investment objectives are stated elsewhere in the annual report, along with the trustees' evaluation of the extent to which the objectives are being met over a meaningful period of time.

2/ Some States have only one retirement fund, others have several funds under separate managements and reporting separately, and many States have common management and one report on several funds (even including non-retirement funds). Non-retirement assets should not be included in this summary, but there is no single correct answer to whether a state with several retirement funds should combine their results into one summary or have separate summaries for each.

These returns are net after transaction costs and any investment management fees.

Any of the fund's assets not included here (e.g., real estate holdings for which market values are not readily available) are noted in Item 2, Asset Allocation.

Some States deem it important to emphasize other rates of return, such as "effective rate," "cash return on book value," or "contractual rate." Simple "total return" is emphasized here because it is most comparable and commonly readily available.

3/ Even pertinent comparisons require use with care. Thus, comparing The Fund's results to the Consumer Price Index shows what "real" returns have been earned; but for much of the 1970's, inflation outpaced most financial holdings and thus most institutional investors.

Comparison to other state retirement funds [or, at least, public funds] is particularly pertinent for funds with significant statutory restrictions on their investments (e.g., "not more than 25% in equities", and/or only limited or no holdings in companies which do not satisfy statutory quality or size restrictions, etc., set forth elsewhere in the report). A fund with statutory restrictions on its equities can show how its performance is affected by those restrictions by disclosing an additional "index" which includes only the securities it could hold; numerous funds already maintain such an "approved list index."

In addition, and especially for the expanding number of state funds operating under a "prudent investor" standard, comparison to non-public retirement funds should be given; but even if that comparison is to relatively large funds, it is important to remember that state funds tend to be far larger than all but a handful of non-public funds.

If the statutory criteria for permissible investments have changed significantly during the last 10 years, include footnote indicating date(s) of change(s).

4/ Investment returns are not validly compared without taking into account the relative risk assumed. A simple analogy: if one person held savings in an insured savings account subject to no other risk than inflation and at interest of, say, 6%; and a second person held savings in gambling stocks, new issues of high technology firms and low-quality bonds, for a total return of say, 7%--then it should be clear that the first person, despite a lower nominal return, secured better results in light of the risk assumed. The second person's portfolio would have been much more volatile and also bore significant risk of default. Certainly it would be misleading to compare those two investment returns with no attention to relative riskiness.

A fund of securities less risky than the S&P 500--less volatile in price and less likely to suffer bankruptcy, securities like utilities--is likely to do less well than the index in "up" markets but better in "down" markets. Conversely, a fund invested in securities riskier than the S&P 500--like smaller, newer firms in newer industries--is likely to do better than the index in "up" markets but worse in "down" markets.

If a fund bore less risk than the index, it should not be expected to do as well in "up" markets, but question remains of how well it did do, relative to the index, in light of its lower riskiness. Conversely, a fund bearing more risk than the market may or may not have gained enough additional return to compensate for its additional risk.

There are various ways of evaluating risk, no one of which captures all aspects of risk and no one of which yet has such widespread support as to warrant imposing it on all funds. The most common risk evaluation, albeit not uncontroversial, is "beta" for equities: a numerical measure of the volatility of a stock portfolio (or of a single stock) associated with the S&P. E.g., a fund with a beta of 1.10 historically rose 10% more than a rising S&P or fell 10% more than a falling index; a beta of 0.5 is likely to be half as volatile as the index. Using beta, total return figures can be adjusted to give "risk-adjusted total return".

Also in common use for stock or bond or total funds is the "standard deviation," measuring a fund's volatility of returns (their dispersion, say, monthly, around their average) over a substantial period. Another related method of evaluating a stock portfolio measures its diversification relative to the index ("R-Square"). Also used, although not lending itself to ready comparison, is categorization of a stock portfolio's securities' characteristics: e.g., credit ratings, earnings growth rates, dividend yields and growth rates, average price-earnings and price-book value ratios, etc.

For bonds, risk evaluation has no single method in as common use as beta for stocks, but here too numerical measures exist. "Duration" measures sensitivity to interest-rate changes: it gives the percentage change in the market price of a bond portfolio (or of a bond) which would accompany a 1% instantaneous change in interest rates. Also in use are portfolio characteristics relatively more comparable than for stocks: e.g., average coupon and yield to maturity, weighted average maturity, diversification among sectors (such as Government, utility, telephone, industrial), proportions of the portfolio at each credit rating, and the maturity profile (what proportion are original maturities of 10-and-more years, what proportion 5-10 years, etc.).

Some funds may not disclose (or even routinely keep) such risk measures as beta and standard deviation, but there is no difficulty in securing such data. While they may not suffice in themselves, they add to the understanding of a fund's relative risk level, understanding which is crucial to evaluating the investment results.

5/ Results from such holdings are not shown separately because comparison with other funds would not be valid without considerable information about the particular investments.

6/ These are equities-only returns, with no cash equivalents. These returns are calculated as if equities were run as a separate portfolio, so as to make possible comparison among funds whether they have such a portfolio or have only portfolios which also have varying proportions of cash-equivalents, or of bonds, or of both. A fund's actual proportion of equities or cash may be determined directly by the fund itself, or may be the result of several outside firms' discretionary judgments.

7/ The S&P 500, as the most frequently used broad market index, should be included to facilitate comparative evaluation of the Fund's own results. Some funds may add the Dow-Jones because it is so widely known, or the Dow and others like the

NYSE or S&P 400 to show how different classes of equities performed. And some portfolios invest substantially enough in issues outside the S&P 500 that they may wish to add a broader index, e.g. the Wilshire 5000. However, the correlation between the S&P 500 and broader weighted indexes has been very high over the last decade.

8/ Comment in footnote 6 applies for the fixed-income returns too.

Note should be given of how the fixed-income securities are valued, e.g., which outside firm's figures, or what other process, are used; and what proportion are so valued. E.g.:

"Publicly traded: ______% of F-I securities
"Other bonds: ______% of F-I securities
"Mortgages: ______% of F-I securities

"The 'other' assets in Item 2-d, are valued as indicated at p. ____ of the report."

9/ No single bond index is as common a benchmark as the S&P 500 is for stocks, because traditional bond indexes differ from most actual bond portfolios in such key characteristics as average maturity, credit quality, and allocation between corporate and government bonds.

A "common denominator" bond index, like the Lehman Bros.-Kuhn Loeb Corporate/Government Index or Merrill Lynch Master Bond Index, should be presented to facilitate comparison with other funds and to evaluate The Fund's results overall. If that first index does not reasonably reflect The Fund's own objectives, the fund might present an additional index better reflecting its own investment objectives, aimed at evaluating how well it has carried out its objectives. For example, a fund which rarely holds more than a small proportion of its bonds in U.S. Governments, or a fund which rarely holds a significant proportion of long-maturity bonds, would be only crudely compared to, say, the LBKL Corp./Govt. Index. Selection of any additional index must reflect long-term objectives, so that there is no need to change the index as the portfolio changes within its long-term guidelines.

10/ Results of investments in cash-equivalents with original maturities of one year or under, and of minimal cash holdings. Indicate how return was calculated.

Uninvested cash (producing no income) averaged about ___% of total assets.

Exhibit 4

South Dakota Investment Council
Analysis (May, 1982) of 23
"In-State" Mortgage Packages
Privately Placed with State and Local
Retirement Funds, Oct. 1980-March 1982

SOUTH DAKOTA INVESTMENT COUNCIL
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101 South Main
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MEMORANDUM

May 27, 1982

TO: Stephen R. Myers, Investment Officer

FROM: Scott A. Bettin, Director of Operations

SUBJECT: Analysis of the MGIC ABM Presented to South Dakota

I. Introduction

In doing the analysis of the proposal MGIC provided information concerning the twenty-four private placements done by MGIC since October 1980. This memo analyzes the twenty-four other private placements as if they were done with South Dakota as well as the adjustable balance mortgage program presented on February 19, 1982. In doing the analysis such items as the pricing, and the liquidity and quality characteristics were covered. Other items also covered are the risks and returns of today's fixed income markets, the economic benefits to South Dakota, and a recommendation for appropriate rules governing participation in mortgage related securities.

The reader should keep in mind that when comparing the pricing of the MGIC private placements to GNMA's, FHLMC's, and conventional mortgage pass-through certificates it may be difficult to draw any conclusions from the data. This is due to the fact that there may be different investment objectives in the funds which have purchased these programs. South Dakota investment objectives require risk-adjusted returns whereas, other public bodies may have other objectives as a result of asset size considerations, political direction or other public pressures.

II. The Other MGIC Private Placements

MGIC placed twenty-four private placement mortgage packages from October 1980 to March 1982. Of the twenty-four packages twenty-two had been priced with one having two portions being priced separately. As a result, for purposes of analysis there were twenty-three programs which were priced.

The analysis was done in a manner in which comparisons were made between the pricing and bond equivalent yields of the individual programs and GNMA's, FHLMC's, and conventional mortgage pass through certificates bond equivalent yields. The comparative yields and price differentials resulting from this analysis appear in Exhibit I. The information in Exhibit I shows that, on average, the MGIC programs were priced at 149 basis points below GNMA yields, 177 basis points below FHLMC yields, and 196 basis points below conventional mortgage pass-through yields.

When looking at the various programs and where they were priced it was assumed that a $20 million investment was made. Exhibit II shows the yearly income difference from the yield spreads of each program. As can be seen, the average dollar giveup each year is $298,000 versus GNMA's, $354,000 versus FHLMC's, and $392,000 versus conventional mortgage pass-through's.

The average lives (maturity) for the majority of the programs is twelve years, the same as a GNMA. The programs which are second mortgages have average lives of six to eight years. If, for the purpose of this analysis, one were to assume an average life of twelve years for all of the programs the total interest concession, including reinvestment income at ten percent, as compared to GNMA's, FHLMC's and conventionals is as follows:

Reinvestment Rate	MGIC vs GNMA	MGIC vs FHLMC	MGIC vs Conventional
10%	$6.9 million	$8.2 million	$9.0 million

These numbers are the future values of the stream of interest concessions. To get a realistic picture of the above table it is better to calculate the present values of the above numbers.

Reinvestment Rate	MGIC vs GNMA	MGIC vs FHLMC	MGIC vs Conventional
10%	$2.2 million	$2.6 million	$2.9 million

The reader should keep in mind that the analysis thus far has not ajdusted for the liquidity and quality differentials which exist between MGIC private placements and the other securities. GNMA's are used as the benchmark to determine a true market rate for the MGIC programs because GNMA mortgages are guaranteed by the U.S. Government and represent the highest available quality for mortgages. Very large amounts of these securities trade on a daily basis in the marketplace. Any mortgage security which offers a lesser degree of quality or liquidity should provide the investor with additional yields. According to the Salomon Brothers "Bond Market Roundup" the yield premium of high-quality publicly-traded conventional mortgage pass-through's to GNMA's ranges from 40 to 100 basis points. To compensate for the lower quality and liquidity present in the MGIC private placements it seems appropriate to pick as a proper yield premium the 100 basis point level. The 100 basis points is the adjustment on average and may be generous on the issues with ratings below "AA" or not rated. Given the 100 basis point yield premium which should exist over GNMA's, the MGIC programs were priced at levels that were, on average, 250 basis points below GNMA's. The yearly interest giveup on an investment of $20 million amounts to $500,000 or $11.5 million including income on reinvested interest at 10% for a twelve year period. The $11.5 million is worth $3.7 million in today's dollars.

III. The MGIC Adjustable Balance Mortgage for South Dakota

(lengthy analysis omitted)

MGIC Mortgage Marketing Corporation
a subsidiary of MGIC Investment Corporation

MGIC Mortgage Marketing Corporation
Insured Conventional Mortgage Pass-through Securities Sold
Summary to Date: Total $674.5 million
($358 million closed; $316.5 million committed)

Investor	Date Committed	Amount
New York Life "A"	7/79*	$35 million
New York Life "B"	8/79*	$25 million
AETNA	8/79*	$20 million
Texas Teachers Retirement System I	10/80*	$21 million
Massachusetts Public Employees	10/80*	$19 million
Second Home Multiple Thrift Investors	12/80	$14 million
Alabama Retirement Systems I	2/81*	$21 million
Michigan Public Employees I	3/81*	$67 million
Alabama Retirement Systems II	4/81*	$23 million
Kansas Public Employees I	4/81*	$15 million
State of South Carolina	4/81*	$30 million
Texas Teachers Retirement System II	5/81*	$16 million
City of Philadelphia	6/81*	$20 million
Investors Savings & Loan	6/81*	$24 million
Alabama Retirement Systems III	7/81	$20 million
New York State Comptroller+	8/81*	$22 million
Milwaukee Building Trades Pension Trust Fund and Electrical ✓ Construction Industry Pension Plan	9/81	$5.5 million
Texas Teachers Retirement System III	9/81	$26 million
Utah State Retirement System I	9/81	$20 million
ERISA? Westinghouse Credit Corporation	9/81	$29 million
Utah State Retirement System II	9/81	$30 million
Kansas Public Employees II	10/81	$40 million
Wyoming Treasurer	10/81	$27 million
Alabama IV	12/81	$36 million
Texas Teachers Retirement System IV	2/82	$11 million
New York State Teachers Retirement+	2/82	$28 million
Michigan Public Employees II	2/82	$50 million

(+security issued through subsidiary Investor Services Corporation)
(*indicates issue had closed)

* Revised 2/11/82 *

Issue #(*)	Investor Commitment Date	Issue $ Committed	Amount Closed	P-T Rate	Price	Yield**		Closing Date	Rating	Loan Type	Property Types
						Mortgage Eqv.	Bond Eqv.				
1	10/27/80		$20.7 mil	12.4	94.5	13.11	13.47	3/18/81	AA	Fixed Rate 12yr Avg	Single Family, Townhous Condos
2	10/31/80		19.1 mil	13.375	100	13.225	13.595	4/22/81	AA	Fixed Rate	Single Family, 2-4 Fami Townhouse, Condos
3	12/23/80	13.8 mil		75 bp above FHLMC auction	98.5	To be determined		7/21/82	None	3-yr ARM	All Second Homes - Sing family, Townhouse, Conc
4	2/26/81		20.1 mil	12.4	94.4	13.23	13.60	10/25/81	AA	Fixed Rate	Single Family, PUD, Tow house, Condos (Max 25% T.H. & Condos)
5	3/24/81		66.6 mil	12.375	93.5	13.43	13.81	11/18/81	AA	Fixed Rate	Single Family, PUD, Tow house, Condos (Max 25% T&H Condos)
6	4/03/81		22.9 mil	12.40	92.875	13.45	13.84%	11/24/81	AA	Fixed Rate	Single Family, PUD, Tow house, (Max 5%), Condo (Max 5%)
7	4/16/81		14.6 mil	13.00	100	12.86%	13.21%	9/24/81	AA	3-yr. Adj Rate (ARM's)	Single Family, PUD, To house, Condo (Max 30% T.H. & Condos)
8	4/24/81		30.1 mil	13.25	94.375	14.145%	14.565%	12/17/81	AA	Fixed Rate	Single Family, PUD, To house (Max 20% T.H.)
9	5/22/81		15.5 mil	16.75	100	16.50	17.08%	8/26/81	AA	Fixed Rate All Second Mortgages 6-8 yr life	Single Family, PUD, To house, Condo (Max 33% T.H. & Condo)
10	6/04/81		19.6 mil	14.375	100	14.21	14.650	12/22/81	AA	Fixed Rate	Single Family, PUD, To house, Condo (Max 20%) 2-4 Family (Max 10%)

			10.7 mil 7.6 mil [illegible]	11.50 12.25							house, Cond , 2 Family, (Max 20% T.H. & Condo & 2 Family)
12	7/16/81		5.9 mil	15.25	96.0 - owner-occupied 95.5% - Second homes	15.56 16.03	16.06 - owner-occupied 16.53 - Second homes	2/28/82	AA	Fixed Rate	Single Family, PUD, Town house Garden Condo (Max 15% T.H. & Condo (Max 5 Single Family, PUD, Town house, Condo (Max 66 2/ T.H. & Condo) - 2nd Home
13	8/11/81		26 mil	14.75	100	14.58%	15.03%	1/12/82	AA	Fixed Rate	One to four Family, only
14	9/01/81		18.4	9.75	98.5	9.85	10.05	2/28/82	A	ABH	Single Family, PUD, Town house, Condos (Max 25% T.H. & Condos)
15***	9/18/81	5.5 mil		14.25	100	14.09	14.51	8/31/82	None	Fixed Rate w/ escalation after 3rd yr.	Single Family, PUD, Town house, Condos, (Max 25% T.H. & Condos)
16	9/25/81		10.2	18.00	100	17.97	18.66	2/23/82	AA	Fixed Rate All Second Mortgages	Single Family, PUD, Town house, Garden Condos (Max 33% T.H. & Condos)
17	10/05/81	30 mil		9.75	98.5	9.85	10.05	4/21/82	A	ABH	Single Family, PUD, Town houses, Condos (Max 25% T.H. & Condos)
18	10/20/81	40 mil		13.50	96.0	15.65	16.17	6/30/82	AA	3-yr. Adj Rate (ARM)	Single Family, PUD, Town houses, Condos (Max 30% T.H. & Condos)
19	11/04/81	25 mil		12.25	100	12.12	12.43	3/30/82	A	Fixed Rate	Single Family, Townhouse Condos, PUD
20	11/23/81	20 mil		16.00	100	15.79	16.32	4/30/82	AA	Fixed Rate (All Second Mtg.)	Single Family, PUD, Town house, Garden Condos (M 33% T.H. & Condo)
21	2/04/82	20 mil		16.00	100	15.99	16.52	6/18/82	AA	Fixed Rate	Single Family, PUD, Town house, Garden Condos (M 30% T.H. & Condos)

22	2/04/82	25 mil	17.25	To be determined	17.05	17.67	10/30/82	AA	Fixed Rate	Single Family, PJD, Townhouse, Condos - Owner Occupied, Single Homes, Investor Owned
23	2/12/82	50 mil	14.375	93.5 (incl. ½ of 1% up)	15.41	15.91	10/19/82	AA	Fixed Rate	Single Family, Townhouse, Garden Condos (Max 25% T.H. & Condos)
24	3/03/82	30 mil	To be Calculated based upon the Federal Farm Credit Bank Notes due 1992.				10/28/82	AA	Fixed Rate Based on FFC Bank Note	Single Family, Townhouses, Condos (Max 20% T.H. & Condos)

*Pools have been numbered consecutively by date for purposes of this report.
**Average life varies by type of mortgage instrument
**Private Pension Fund Issue.

GEORGETOWN UNIVERSITY LAW CENTER
WASHINGTON, D. C. 20001

ROY A. SCHOTLAND
PROFESSOR OF LAW

December 16, 1983

The Honorable William Clay
The Honorable Charles B. Rangel
The Honorable John N. Erlenborn
The Honorable Steve Bartlett
United States House of Representatives
Washington, D.C. 20515

Dear Congressman Rangel:

At the Joint Hearing held by the Ways & Means Subcommittee on Oversight and the Education & Labor Subcommittee on Labor-Management Relations on the "PEPPRA" bill (Public Employee Pension Plan Reporting and Accountability Act), I had the privilege of testifying for the fifth time on this legislation, and of commenting on the then-forthcoming study by the National Council on Teacher Retirement. Now that the Council has released its preliminary report for your hearing record, I would appreciate the opportunity to add these comments on that report, to that record.

The NCTR's preliminary report concludes that "Federal regulation of state and local pension funds is unnecessary and inappropriate because the States are already doing the job." "The job" is to assure fiduciary protections surrounding the management of about $120 billion on behalf of over 5,000,000 active participants. Much experience indicates that meaningful disclosure is one of the most effective and least intrusive protections. The proposed "PEPPRA" legislation pending in Congress provides mainly for disclosure.

How well do the state teachers' funds surveyed by NCTR disclose what they are doing? As I testified in a PEPPRA Hearing before the NCTR Report came out, they used

> a fine questionaire covering very important areas, but not really getting into the nitty-gritty of the investment area with anything like accuracy. Anything it brings out on investment information, I am afraid, will have to be amplified by further material.

One of the systems NCTR included, Ohio State Teachers, has exemplary disclosure on its investment results and on an exhaustive array of other matters which participants and taxpayers need to know if management of such massive sums is to be accountable. Ohio is so fine and so unusual that I included excerpts from its reports in my testimony, and in 1980 awarded it my first annual "Godiva" award for outstanding disclosure (an award deemed significant enough that another winning system, New York's Common Retirement Fund, featured it on page one of their next report--this year's winner is South Dakota, for unprecedentedly thorough investment reporting).

However, brief note of four systems covered by NCTR, and claimed by NCTR to indicate that "nothing's broke so nothing needs fixing," proves how primitive are the norms.

Start with New York's Teachers. Their annual report gives us the results for the Dow-Jones Industrials, but not for their own fund. (1982 Report, p. 10). Even if a "bottom line" cannot tell all, surely it tells enough to be included. More and more state systems are reporting their "total returns," but NCTR ignores this crucial and still widespread gap that reveals either primitivism or conscious preference for avoiding accountability.

(That New York report is extraordinary in claiming without substantiation good investment earnings, then saying that such results cannot lead to improved benefits because the teachers are raising liabilities by improving their longevity! (p. 3, Has any public entity every voiced so odd a complaint about its constituency? Contrast the Ohio Teachers' report:

> Each 1% increase in investment return will finance benefit improvements in the range of 10%-15%, or will allow a similar reduction in contributions. Such gain may also be used to improve the actuarial condition of the plan.

Texas Teachers' was another major system NCTR believes has good enough disclosure. Is it good enough to report with high visibility that the fund's bonds are worth $4.7 billion, when $1.1 billion of that is gone because of bond value declines, which an indomitable reader can find down in the middle of a long footnote, pages later? (1982 Report, pp. 5 and 9) And Texas Teachers' is much better than many, many state systems and even more local ones, which do not give market values at all--see, e.g., Texas Public Employees.* Reporting securities only at cost and ignoring market values is a practice that was itself retired long ago by all private plans and more and more public plans.

Missouri's Public School Retirement System, not only in NCTR's survey but also by writing its Congressional delegation that all is well with most public plans, perfectly exemplifies the primitivism of most state and local plans' disclosure. As is too typical, MPSRS gives market values on stock holdings--but not on the other 85% of its portfolio (1981 Report, Comparative Financial Statement). As is too typical, they do not disclose their total return (p. 3). But they do disclose figures that would make any investment professional giggle or blush: they have added up the total number of shares they hold (e.g., 10,000 shares of AT&T plus 20,000 shares of IBM plus 30,000 shares of GM, etc., equals 60,000 shares), to reveal the nonsense fact that they hold a total of 6,296,311 shares ("Summary of Investments"). I do not giggle, I blush and am appalled.

To see what crucially important matters are buried when disclosure is incomplete or primitive, take Utah as an example of what NCTR wholly ignores. Commendably, Utah does disclose its total return, 23.8% (for calendar 1982), and they note that their performance is evaluated by A.G. Becker--but they fail to disclose that the Becker median state fund that year earned 29.9% (1982 Report, p. 17). But that gap is minor. If you were in Utah, wouldn't you want to know what explains this: Utah's $1.1 billion fund began 1982 with stocks worth $282 million and during the year, bought $254 million and sold $221 million. The fund began 1982 with bonds (long-term only) worth $479 million and during the year, bought $926 million and sold or redeemed $774 million (1982 Report, p. 35). Churning? Better reasons? We are told nothing. If you were a Utah participant or taxpayer, wouldn't you want to know more?

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* Or consider Texas' capitol city of Austin, which does include market values but, in its 1982 Employee Retirement Fund Annual Report, noted in its cover letter "an extraordinary year in investment returns"--despite these facts: (1) nowhere does the report disclose the fund's total return; (2) the reader who persists to page 31 will discover that this fund, with an average balance of $104 million, realized net capital losses of $2,074,975 in contrast to a loss of $39,919 the prior year; and (3) the disclosure of the fund's balance is by methods "not in conformity with . . . generally accepted accounting principles; however, the effect . . . is not material." (p. 32, footnote)

(If you were an Arizonan, you'd have even more need for disclosure on the same problem: Their state retirement system ended fiscal 1982 with $900 million in long-term bonds, having bought during that year $1.6 billion and sold or redeemed $1.4 billion; ending with $497 million in stocks, they had bought $512 million and sold $456 million. Wow.)

Disclosure alone is a key protection holding pension managers accountable and promoting better performance, which are the direct interests of not only participants in those plans but also taxpayers including Federal taxpayers, the ultimate pension insurers. Disclosure practices of public plans have been shown, so many times over so many years in so much concrete detail, to be primitive or worse. The only question is how much longer we will wait to use this key protection to get out the facts before the problems get out of control. Disclosure will be effective only if comparable funds' activities can be compared, and only bills like the ones you are considering can bring us this protection.

Sincerely,

Roy A. Schotland

RAS:lcb

Mr. MARTINEZ [presiding]. We will hear from Mr. Halperin.

STATEMENT OF DANIEL I. HALPERIN, ESQ., GEORGETOWN UNIVERSITY LAW CENTER

Mr. HALPERIN. Mr. Chairman, my focus is on the tax provisions. I want to emphasize three main points.

One, as I pointed out in a short written statement, bills that have been introduced on this subject in the past basically say that you get the favorable tax treatment if you comply with the reporting and disclosure standards of the bill.

For reasons that have been discussed earlier this morning, I believe that would be a terrible mistake. Whether somebody is entitled to special Federal tax treatment is a question to be decided by Congress, not to be decided by individuals or companies that establish plans, whether they be State government or private plans.

Second, I think the major difficulty the Internal Revenue Service has is that in the State sector as in the Federal sector the plans for judges and for elected officials can be described as better than the plans for other employees.

That puts the IRS in a terribly embarrassing position. They can't very well go after employee plans on the basis that they discriminate without somebody pointing out the fact that they are not touching the judges' plans and not touching the legislators' plans.

It is unrealistic to expect the IRS to make an announcement that the plans for Federal and State legislators are not exempt from Federal income tax. They are entitled to a signal from Congress as to what Congress wants them to do about that area.

I think that the proper signal probably is to say these are special problems, they ought to be distinguished, they ought not to be subject to the general antidiscrimination rule.

Third, we have heard a lot of talk about the fact that the tax sanctions won't work properly because ending tax-exempt status will harm the employees and not anybody else.

I think what one can say about the Federal tax sanctions is that they don't work perfectly, but they work a lot better than anything else we can figure out and they do work.

Employers do arrange the plan so that it does not lose the Federal tax status. Penalties are not in fact imposed on employees very often. It works to keep plans in line and it can do the job.

I think the major difficulty is to give the signal, to get the IRS off the hook it is now on with respect to having to treat plans for legislators and judges specially without being told they should do so by Congress.

[The prepared statement follows:]

STATEMENT OF DANIEL I. HALPERIN, PROFESSOR, GEORGETOWN UNIVERSITY LAW CENTER

Tax benefits of qualified plans—including deferral of tax for funded vested benefits, rollover or special averaging for lump-sum distributions and estate tax exclusion—should depend upon meeting the standards of the Internal Revenue Code. Special treatment for state and local government employees is unwarranted.

1. Under the Internal Revenue Code special tax benefits are provided for plans (so-called qualified plans) that do not discriminate in favor of highly paid employees and have limits on the amount of contributions and benefits.

2. Legislation has been introducted which would provide these benfits to government plans that meet certain requirements as to disclosure, reporting and fiduciary standards without regard to coverage of employees and perhaps without limit on the amount of benefits for any one employee.

3. This has been described as elimination of federal government intrusion into areas best left to state and local discretion—setting of contributions and benefits. Such a description is a fundamental and dangerous error.

4. The states have full freedom to set the salary of their employees and to determine how much of that salary should be paid currently and how much deferred to retirement. But that salary is taxable. If special tax benefits are apply, it is the responsibility of the Congress to determine the conditions for such special treatment. It does not cost local governments to dispense special federal tax treatment and there is no reason to expect they will limit it to plans that further fundamental goals of public policy.

5. The purpose of the special tax benefits is to encourage establishment of retirement programs for rank and file employees, which together with Social Security would permit them to continue their pre-retirement standard of living. This incentive is weakened if the special benefits are available to high income employees even if the low and moderate worker is not benefitted. Some bills would seem to provide special treatment for plans established to benefit one individual and perhaps where deferral is at such individual's option. Such plans do not further public policy goals. Further, there is no reason to permit tax deferral of excessive amounts—amounts beyond the generous limits set by the Internal Revenue Code.

6. Because state and local governments are tax-exempt, it has been difficult to deny the benfits of qualified plans to unfunded arrangements. But since 1978 there has been a limit on the amount of income that can be deferred under unfunded plans (§ 457 IRC). The legislation described would totally reverse the 1978 legislation.

7. If conditions peculiar to government require modification of the normal nondiscrimination rules (perhaps to take account of the circumstances applicable of Judges and elected officials), this can be done without gutting the entire policy. If local government officials would indicate which provisions of the Internal Revenue Code cause difficulty and in what circumstances, a dialogue can begin.

Mr. Martinez. Mr. Halperin, would you expand a little bit on how you believe the public employees would benefit if this plan is enacted?

Mr. Halperin. In terms of the disclosure, I am not an expert in that area. I am primarily a tax lawyer. I have been in Treasury in the past and interested mostly in the Federal tax provisions.

I think it is clear that we expect people to be able to adequately respond to whether they are getting adequate pensions. We expect the State voter to understand whether they are paying for something and how much they are paying for something.

I think that disclosure reporting in a way that it can be understood is important.

I think the testimony today has adequately indicated while some people will provide adequate reporting and disclosure without Federal legislation, it will be a long time before you get it from all plans, particularly from the ones that are most in trouble, which would be at the municipal rather than State level.

Mr. Martinez. Thank you.

Mr. Bartlett.

Mr. Bartlett. I have no questions.

Mr. Martinez. That concludes the testimony today.

The meeting is adjourned.

The record will remain open until November 28.

[Whereupon, at 2:10 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATEMENT OF THE AMERICAN ACADEMY OF ACTUARIES

I. INTRODUCTION

The American Academy of Actuaries ("Academy") appreciates the opportunity to submit comments with respect to potential legislation involving public employee pension benefit plans. the Academy is vitally interested in such legislation, since the large majority of actuaries performing actuarial services for state and local public employee retirement system [PERS] are members of the Academy. Appendix A contains some background information about the Academy.

While legislation has not yet been introduced on which to comment, there are several issues which had been a part of previous legislative proposals and with respect to which we have substantial interest. Specifically, we would like to comment here on three issues:

(1) Actuarial standards for pension disclosure;
(2) The relationship between actuaries and accountants;
(3) Pension terminology.

We appreciate the opportunity to provide input into this process. We would look forward to the opportunity to working with the staffs of your committees as they draft specific legislative proposals.

II. ACTUARIAL STANDARDS FOR PENSION DISCLOSURE

Previous legislative proposals in this area have included significant disclosure requirements.

There are several projects in process within the actuarial community concerning the question of disclosure of actuarial information relation to retirement programs, public and private. For example, the Conference of Actuaries in Public Practice (one of the founding organizations of the Academy) is in the process of developing a set of standards in this area which focus on single employer plans in the private sector. A copy of an exposure draft they have prepared on this subject is attached as Appendix B. We would appreciate the opportunity of working with the Committees as they develop a set of disclosure principles for public sector plans. To the extent that the anticipated legislative proposals will address disclosure of actuarial information with respect to PERS, disclosure requirements which parallel professional standards would certainly simplify the implementation of these requirements.

III. THE RELATIONSHIP BETWEEN ACTUARIES AND ACCOUNTANTS

The relationship between actuaries and accountants under the Employee Retirement Security Act of 1974 ["ERISA"] is important background to consider, since the general framework of any legislative proposal dealing with public employee retirement systems should certainly be similar to that contained in ERISA in this area.

ERISA has given rise to an unresolved problem in the auditing area. Section 103 of ERISA provides that the accountant may rely on the correctness of any actuarial matter certified to by an enrolled actuary, if he so states his reliance (and, conversely, that actuaries may rely on the work product of qualified accountants in an analogous manner). However, this provision has never become operational in the manner in which Congress intended. This results from audit guidelines (which predate ERISA) issued by the American Institute of Certified Public Accountants [AICPA] which state that any opinion of an auditor which expresses reliance on the work of others becomes a "qualified opinion", with all the resulting negative connotations attached to that term. The AICPA has not changed this position, despite the statutory authority for such expression of reliance contained in ERISA.

The Academy would strongly endorse provisions in any proposed legislation dealing with PERS which would mandate compulsory reliance in both directions rather than the voluntary reliance of ERISA. We believe that such provisions would be quite beneficial in resolving the difficulties which have arisen under ERISA, as described earlier. Furthermore, we believe that they are quite compatible with the division of responsibilities between actuaries and accountants intended by the Congress in the implementation of Section 103 of ERISA.

IV. PENSION TERMINOLOGY

Over the years a variety of pension terminology has evolved in laws and regulations and in the pension literature. A number of attempts have been made to develop terminology which would be commonly used by all practitioners involved in the pension field.

The actuarial profession recently received a report from the Joint Committee on Pension Terminology composed of representatives from various actuarial organizations. This Committee's charge was to arrive at a more uniform, consistent, and unambiguous set of terminology. This report has now been formally endorsed by the governing bodies of all United States actuarial organizations dealing with pension matters. The report is submitted for the consideration of the Committees as Appendix C. The Academy feels that any proposed legislation dealing with PERS should contain terminology which is consistent with these generally accepted standards. We would look forward to the opportunity to assist the staffs of the committees in implementing such an effort.

V. SUMMARY

While the Academy has no position relative to the desirability of federal legislation regulating public employee retirement systems, it does feel strongly that such legislation if enacted should:

(1) Be consistent with the emerging actuarial standards for pension disclosure;

(2) Clarify the relationship between the actuarial and accounting professions; and

(3) Be drawn so as to be consistent with the new pension terminology which is gaining increased acceptance throughout the pension community.

APPENDIX A—BACKGROUND INFORMATION ON THE AMERICAN ACADEMY OF ACTUARIES

The American Academy of Actuaries is a professional association of actuaries which was formed in 1965 to bring together into one organization all qualified actuaries in the United States and to seek accreditation and greater public recognization for the profession. The Academy includes members of three founding organizations—the Casualty Actuarial Society, the Conference of Actuaries in Public Practice, and the Society of Actuaries.

The Academy serves the entire profession. Its main focus is the social, economic, and public policy environment in which the actuarial profession functions. Its primary activities include liaison with federal and state governments, relations with other professions, public information about the actuarial profession and issues that affect it, and the development of standards of professional conduct and practice.

Over 7,400 actuaries in all areas of specialization belong to the Academy. These members are employed by insurance companies, consulting actuarial firms, government, academic institutions, and a growing number of industries. Actuarial science involves the evaluation of the probabilities and financial impact that uncertain future events—birth, marriage, sickness, accident, retirement, and death—have on insurance and other benefit plans.

Membership requirements can be summarized under two broad headings: education and experience. At present, the education requirements can be satisfied either by passing certain professional examinations sponsored by the Casualty Actuarial Society or the Society of Actuaries, or by becoming an enrolled actuary under the Employees Retirement Income Security Act of 1974 [ERISA]. The experience requirement consists of three years of responsible actuarial work.

PENSION TERMINOLOGY

Final Report

July 31, 1981

American Academy of Actuaries • American Society of Pension Actuaries
Conference of Actuaries in Public Practice • Society of Actuaries

FINAL REPORT
OF
JOINT COMMITTEE ON PENSION TERMINOLOGY

JULY 31, 1981

INTRODUCTION AND EXPLANATORY COMMENTS

Directive and Makeup of Committee -

The Joint Committee on Pension Terminology was formed by the American Academy of Actuaries, the Canadian Institute of Actuaries, the Conference of Actuaries in Public Practice and the Society of Actuaries to develop a consensus of actuarial terminology for pension plans that would be accepted as a standard by their members. Committee members and the organizations they represent are as follows:

Committee Members	Representing
Thomas P. Bleakney	American Academy of Actuaries
Donald L. Gowing	Canadian Institute of Actuaries
Richard C. Keating	Conference of Actuaries in Public Practice
Charles R. Keene	Conference of Actuaries in Public Practice
Owen A. Reed	Canadian Institute of Actuaries
Albert C. Simmonds, III	American Academy of Actuaries
Michael J. Tierney (Chairman)	Society of Actuaries
Gerald I. Wilson	Society of Actuaries

Why Committee Established -

The search for standard pension terminology has been frustrating the actuarial profession for some time. The meshing of common usage and a standard set of terms has not yet been successful. Some terms are poorly defined, while others are misleading, producing many misunderstandings. Previous attempts to solve the standardization problem have not been widely accepted. Therefore, the Joint Committee was appointed in 1978 to develop a consistent set of terms and definitions that would be accepted and used by a majority of pension actuaries.

Procedures -

This report is the result of numerous Committee preliminary drafts and comments received after (1) publication of the Committee's Core Term Exposure Draft, (2) information hearings held in five locations throughout the United States and Canada during 1980, (3) distribution of the Final Exposure Draft to the members of the sponsoring organizations in February, 1981, and (4) consultation with members of the American Society of Pension Actuaries. Many changes were made to the report as a result of this feedback.

Endorsement -

The following organizations representing actuaries have formally adopted this report of the Joint Committee and have recommended that its members use the terminology as outlined in this report:

Organizations	Board Adoption
American Academy of Actuaries	June 3, 1981
American Society of Pension Actuaries	July 19, 1981
Conference of Actuaries in Public Practice	July 27, 1981
Society of Actuaries	April 29, 1981

General Committee Guidelines -

The Committee has adopted the following general guidelines:

- Preserve traditional terminology where feasible.

- Emphasize proper definitions of terms and methods to promote uniformity, rather than create a new vocabulary.

- Allow some flexibility in term usage to recognize current practice.

- Avoid dictating professional standards through terminology and definitions.

General Terminology Guidelines -

- Base or "core terms" have been defined in order to provide building blocks for the description of methods and procedures.

- A "multiple term" approach has been adopted, allowing the use of more than one term to describe a concept or value, as long as the term is consistently applied. Note that the preferred term is listed first in each multiple term case. This approach has been adopted to allow some flexibility in recognition of current practice. Thus, many practitioners can still use the terms they prefer, but the meaning associated with these alternate terms will now be the same. It is hoped that the preferred term will become the standard term in the course of time.

- Defined terms have been capitalized throughout the report in order to identify them as having special meanings, not necessarily those in "general usage." It is recommended that the names of the actuarial cost methods be capitalized in general use, but that capitalization of the core terms and terms contained in the supplemental glossary be left to the discretion of the practitioner.

- Definitions of terms were made as general as possible, so as to enable their application to as many methods as possible.

- The definitions of actuarial cost methods were made as general as possible to allow flexibility of use. Because of this flexibility, clarifying explanations are to be employed when any Actuarial Cost Method is identified.

"Liability" and "Cost" -

Previous committees addressing terminology questions have avoided the use of the words "liability" and, to some extent, "cost". Although the present Committee accepts many of the arguments advanced for avoiding those words (including their pre-emption by accountants and possible misinterpretation by laymen), the arguments in favor of traditional and intuitively descriptive terminology were persuasive.

The following features of the recommended terminology should be noted:

- "Liability" is always method-dependent; thus "the liability for vested benefits" is not considered proper usage, and should be replaced by "the actuarial present value of vested benefits".

- To emphasize method-dependency, the note following the definition of Actuarial Accrued Liability calls for reference to the name of the method as a hyphenated item when an Actuarial Accrued Liability is presented.

- "Cost" is never used as a synonym for "liability" or "actuarial present value". Thus, one meaning sometimes attached to the phrase "past service cost" is replaced by "actuarial accrued liability", while another meaning is replaced by "amortization payments".

Explanatory Comments -

The following general remarks are intended to assist in the understanding of how the terms and definitions were developed:

- The standard pension terminology was developed primarily for use by actuaries. Although some clarification items were added or expanded in order to allow understanding by the general public, the general public was not considered the primary user.

- Some comments received requested descriptions of specific applications of methods. It is to be emphasized that the terminology report's purpose is to define terms, and is not meant to be a text on specific application of methods. Hopefully, future groups will consider specific applications of the terminology.

- Some comments requested specific duplication of terms in ERISA and IRC Bulletin 23P while others wished to eliminate terms no matter what their history. The Committee chose a middle path, adopting historic terms when possible and modifying or changing those terms only when reasons to change appeared more important. For example, while the term "Attained Age Normal" has much history, it was often used to define two distinct kinds of Actuarial Cost Methods. Therefore, the terms "Attained Age" and "Frozen Attained Age" were proposed to eliminate this duplication.

- The Committee did not address which terms or methods are acceptable under ERISA, as it was thought beyond the scope of the Committee's assignment. Other committees or texts can address how the lexicon should be used in context.

- Some comments asked why terms never before in common usage were adopted either as recommended or alternate terms. One of the reasons for this approach was to coordinate with the work of the Canadian terminology committee. In this manner, terms in common use in other areas could still have the blessing of either report. For example, the term "Normal Actuarial Cost" is not used in the United States, but it is to be the recommended term in Canada.

- The Committee decided not to try to go out of its way to attempt to increase the meaning of any term by adding additional words. Rather, additional words were added only if the present term was considered misleading. For example, the Committee proposed the term "Actuarial Accrued Liability" to be preferred over "Accrued Liability" in order to emphasize the actuarial nature of the term.

The following comments relate to the Core Terms of Section A:

- Term A-1 defines Actuarial Present Value in terms of life contingencies. This allows the use of the term "Present Value" with relation to other financial values, but not for values involving life contingencies.

- A definition suggested for Normal Cost (A-3) was "cost if plan was in existence since each individual's date of hire and funding followed the Actuarial Cost Method without Actuarial Gains (Losses)". The Committee prefers the recommended definition in order to allow the use of the term A-3 for all Actuarial Cost Methods.

- The terms A-4 and A-6 have several alternate expressions in addition to the preferred expressions, "Actuarial Accrued Liability" and "Unfunded Actuarial Accrued Liability." "Accrued Liability" was chosen to provide a link to current usage in practice and in the law. "Actuarial Liability" was chosen to coordinate with Canadian terminology (their preferred term) as well as current practice in the United States. "Actuarial Reserve" was chosen to provide an expression for those who do not wish to use the word "liability" as part of this term.

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- The definition of Actuarial Gain (Loss) (A-8) is broad in order to allow flexibility. For example, a definition such as "the difference between actual and expected Actuarial Accrued Liability" would have to address what actually was paid toward the Unfunded Actuarial Accrued Liability the previous year. In addition, the definition leaves open whether to treat changes in employee group as Actuarial Gains (Losses) or separate Actuarial Accrued Liability increases (decreases), to allow discretion on the part of the practitioner.

The following comment relates to the Actuarial Cost Methods in general:

- The Committee is aware that Actuarial Cost Methods exist other than those defined in the report. It is anticipated that a future terminology committee might address an "exhaustive list" Actuarial Cost Method project. The Actuarial Cost Methods have been defined in a manner general enough to encompass some variations from the "primary method." However, when a method is used which has not been defined, it should be described in sufficient detail so that the method will be clearly understood. Where the method used is similar to one which has been defined, but involves significant variations which do not permit it to be labeled as the defined method, a separate term should be used as a label for that method.

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The following comment relates to the Actuarial Cost Method B-1:

- The phrase "Unit Credit" has been chosen rather than "Accrued Benefit" to be used in the term "Unit Credit Actuarial Cost Method" to avoid possible confusion with the term "Accrued Benefit" which has a more narrow definition than the benefit which the Actuarial Cost Method usually addresses. This choice is consistent with the Committee objective to permit multiple terms but to avoid multiple meanings of the same term.

The following comment relates to the Actuarial Cost Method B-2:

- With regard to Method B-2, the word "normal" is omitted from the Entry Age Actuarial Cost Method name in order to help generalize the term "Normal Cost" as well as to shorten the term.

The following comments relate to Actuarial Cost Methods B-3, B-5 and B-6:

- The word "initial" was not added to the Frozen Entry Age Actuarial Cost Method and the Frozen Attained Age Actuarial Cost Method in order to avoid duplication as well as to keep the term as short as possible.

- It was thought important to clarify the use of "frozen" vs. "unfrozen" methods; therefore, separate terms were proposed and the word "frozen" added to all "frozen methods" in order to assist in the separation of these methods. In addition, the word "normal" was removed from Attained Age Actuarial Cost Method so as not to confuse it with the former frozen method.

The following comment relates to the Actuarial Cost Method B-9:

- "Annual cost allocation" is used to denote the portion of the Actuarial Present Value allocated to a particular year under the Projection Actuarial Cost Method. The "annual cost allocation" under this method has elements of a conventional Normal Cost and Amortization Payment in a mix that is essentially inseparable. Accordingly, the use of the familiar term "Normal Cost" for this purpose introduces a misleading concept for an Actuarial Cost Method.

Section A

CORE TERMS

A-1. **Actuarial Present Value**

The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions.

A-2. Actuarial Cost Method or Funding Method

A procedure for determining the Actuarial Present Value of pension plan benefits and expenses and for developing an actuarially equivalent allocation of such value to time periods, usually in the form of a Normal Cost and an Actuarial Accrued Liability.

Note: An Actuarial Cost Method is understood to be a Closed Group Actuarial Cost Method unless otherwise stated.

A-3. Normal Cost or Normal Actuarial Cost

That portion of the Actuarial Present Value of pension plan benefits and expenses which is allocated to a valuation year by the Actuarial Cost Method.

Note 1: The presentation of Normal Cost should be accompanied by reference to the Actuarial Cost Method used.

Note 2: Any payment in respect of an Unfunded Actuarial Accrued Liability is not part of Normal Cost (see Amortization Payment).

Note 3: For pension plan benefits which are provided in part by employee contributions, Normal Cost refers to the total of employee contributions and employer Normal Cost unless otherwise specifically stated.

A-4. Actuarial Accrued Liability, Actuarial Liability, Accrued Liability, or Actuarial Reserve

That portion, as determined by a particular Actuarial Cost Method, of the Actuarial Present Value of pension plan benefits and expenses which is not provided for by future Normal Costs.

Note: The presentation of an Actuarial Accrued Liability should be accompanied by reference to the Actuarial Cost Method used; for example, by hyphenation ("Actuarial Accrued Liability - XYZ", where "XYZ" denotes the Actuarial Cost Method) or by a footnote.

A-5. Actuarial Value of Assets or Valuation Assets

The value of cash, investments and other property belonging to a pension plan, as used by the actuary for the purpose of an Actuarial Valuation.

Note: The statement of Actuarial Assumptions should set forth the particular procedures used to determine this value.

A-6. Unfunded Actuarial Accrued Liability, Unfunded Actuarial Liability, Unfunded Accrued Liability, or Unfunded Actuarial Reserve

The excess of the Actuarial Accrued Liability over the Actuarial Value of Assets.

Note: This value may be negative in which case it may be expressed as a negative Unfunded Actuarial Accrued Liability, the excess of the Actuarial Value of Assets over the Actuarial Accrued Liability, or the Funding Excess.

A-7. Frozen Actuarial Accrued Liability or Frozen Actuarial Liability

That portion of the Actuarial Present Value of Projected Benefits which is separated as of a valuation date and frozen under certain Actuarial Cost Methods. Generally this separated portion is the sum of an initial Unfunded Actuarial Accrued Liability and any increments or decrements in the Actuarial Accrued Liability established subsequently as a result of changes in pension plan benefits or Actuarial Assumptions.

A-8. Unfunded Frozen Actuarial Accrued Liability or Unfunded Frozen Actuarial Liability

The portion of the Frozen Actuarial Accrued Liability remaining after the addition of interest and the deduction of Amortization Payments.

A-9. Actuarial Gain (Loss) or Experience Gain (Loss)

A measure of the difference between actual experience and that expected based upon a set of Actuarial Assumptions, during the period between two Actuarial Valuation dates, as determined in accordance with a particular Actuarial Cost Method.

Note 1: The effect on the Actuarial Accrued Liability and/or the Normal Cost resulting from changes in the Actuarial Assumptions, the Actuarial Cost Method or pension plan provisions should be described as such, not as an Actuarial Gain (Loss).

Note 2: The manner in which the Actuarial Gain (Loss) affects future Normal Cost and Actuarial Accrued Liability allocations depends upon the particular Actuarial Cost Method used.

Section B

ACTUARIAL COST METHODS

B-1. Unit Credit Actuarial Cost Method

A method under which the benefits (projected or unprojected) of each individual included in an Actuarial Valuation are allocated by a consistent formula to valuation years. The Actuarial Present Value of benefits allocated to a valuation year is called the Normal Cost. The Actuarial Present Value of benefits allocated to all periods prior to a valuation year is called the Actuarial Accrued Liability.

Note 1: The description of this method should state the procedures used, including:

(a) how benefits are allocated to specific time periods;

(b) the procedures used to project benefits, if applicable; and

(c) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, generally reduce (increase) the Unfunded Actuarial Accrued Liability.

B-2. Entry Age Actuarial Cost Method or Entry Age Normal Actuarial Cost Method

A method under which the Actuarial Present Value of the Projected Benefits of each individual included in an Actuarial Valuation is allocated on a level basis over the earnings or service of the individual between entry age and assumed exit age(s). The portion of this Actuarial Present Value allocated to a valuation year is called the Normal Cost. The portion of this Actuarial Present Value not provided for at a valuation date by the Actuarial Present Value of future Normal Costs is called the Actuarial Accrued Liability.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service;

(b) where aggregation is used in the calculation process;

(c) how entry age is established;

(d) what procedures are used when different benefit formulas apply to various periods of service; and

(e) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, reduce (increase) the Unfunded Actuarial Accrued Liability.

B-3. Attained Age Actuarial Cost Method

A method under which the excess of the Actuarial Present Value of Projected Benefits over the Actuarial Accrued Liability in respect of each individual included in an Actuarial Valuation is allocated on a level basis over the earnings or service of the individual between the valuation date and assumed exit. The portion of this Actuarial Present Value which is allocated to a valuation year is called the Normal Cost. The Actuarial Accrued Liability is determined using the Unit Credit Actuarial Cost Method.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service;

(b) where aggregation is used in the calculation process; and

(c) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, reduce (increase) the Unfunded Actuarial Accrued Liability.

Note 3: The differences which regularly arise between the Normal Cost under this method and the Normal Cost under the Unit Credit Actuarial Cost Method will affect the determination of future Actuarial Gains (Losses).

B-4. Aggregate Actuarial Cost Method

A method under which the excess of the Actuarial Present Value of Projected Benefits of the group included in an Actuarial Valuation over the Actuarial Value of Assets is allocated on a level basis over the earnings or service of the group between the valuation date and assumed exit. This allocation is performed for the group as a whole, not as a sum of individual allocations. That portion of the Actuarial Present Value allocated to a valuation year is called the Normal Cost. The Actuarial Accrued Liability is equal to the Actuarial Value of Assets.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service;

(b) how aggregation is used in the calculation process; and

(c) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, reduce (increase) future Normal Costs.

B-5. Frozen Entry Age Actuarial Cost Method

A method under which the excess of the Actuarial Present Value of Projected Benefits of the group included in an Actuarial Valuation, over the sum of the Actuarial Value of Assets plus the Unfunded Frozen Actuarial Accrued Liability, is allocated on a level basis over the earnings or service of the group between the valuation date and assumed exit. This allocation is performed for the group as a whole, not as a sum of individual allocations. The Frozen Actuarial Accrued Liability is determined using the Entry Age Actuarial Cost Method. The portion of this Actuarial Present Value allocated to a valuation year is called the Normal Cost.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service;

(b) how aggregation is used in the calculation process; and

(c) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, reduce (increase) future Normal Costs.

B-6. Frozen Attained Age Actuarial Cost Method

A method under which the excess of the Actuarial Present Value of Projected Benefits of the group included in an Actuarial Valuation, over the sum of the Actuarial Value of Assets plus the Unfunded Frozen Actuarial Accrued Liability, is allocated on a level basis over the earnings or service of the group between the valuation date and assumed exit. This allocation is performed for the group as a whole, not as a sum of individual allocations. The Frozen Actuarial Accrued Liability is determined using the Unit Credit Actuarial Cost Method. The portion of this Actuarial Present Value allocated to a valuation year is called the Normal Cost.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service;

(b) how aggregation is used in the calculation process; and

(c) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, reduce (increase) future Normal Costs.

B-7. Individual Level Actuarial Cost Method or Individual Level Premium Actuarial Cost Method

A method under which the Actuarial Present Value of each increment of an individual's Projected Benefits is allocated on a level basis over the future earnings or service of the individual between the age at which such increment is first recognized and the exit age(s). The portion of this Actuarial Present Value allocated to a valuation year is called the Normal Cost. Each individual's portion of the Actuarial Accrued Liability should be determined on a consistent basis, usually as the retrospective accumulation of the individual's prior Actuarial Accrued Liability and prior Normal Cost, using the valuation Actuarial Assumptions.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service; and

(b) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, Actuarial Gains (Losses), as they occur, result in amortization credits (debits) which offset (supplement) Normal Cost. Increases (decreases) in Projected Benefits from one valuation date to the next usually produce Normal Cost increments (decrements) rather than Actuarial Losses (Gains).

B-8. **Individual Spread Gain Actuarial Cost Method or Individual Aggregate Actuarial Cost Method**

A method under which the Actuarial Present Value of each increment of an **individual's Projected** Benefits is allocated on a level basis over the future earnings or service of the individual between the age at which such increment is first recognized and the exit age(s). The portion of this Actuarial Present Value allocated to a valuation year is called the Normal Cost. The Actuarial Value of Assets is deemed to be assigned to individuals on a reasonable and consistent basis; for example, each individual's share may be the accumulation of his (her) prior Normal Costs and any prior Actuarial Gains (Losses) allocated to the individual. Actuarial Gains (Losses) are allocated to individuals in proportion to the assigned Actuarial Value of Assets, or on any other reasonable and consistent basis. The Actuarial Accrued Liability for an individual equals the assigned portion of the Actuarial Value of Assets.

Note 1: The description of this method should state the procedures used, including:

(a) whether the allocation is based on earnings or service; and

(b) a description of any other method used to value a portion of the pension plan's benefits.

Note 2: Under this method, the Actuarial Gains (Losses), as they occur, reduce (increase) future Normal Costs.

Note 3: This method has the effect of applying the Aggregate Actuarial Cost Method separately for each individual.

B-9. Projection Actuarial Cost Method or Forecast Actuarial Cost Method

A method under which the excess of the Actuarial Present Value of the sum of Projected Benefit payments for a specified period plus a funding objective as of the end of the period over the Actuarial Value of Assets is allocated on a level basis over the earnings or service of the group during the specified period, including earnings or service for any future entrants assumed. The allocation is performed for the group as a whole, not as a sum of individual allocations. The portion of this Actuarial Present Value allocated to a valuation year is called the "annual cost allocation".

Note 1: The description of this method should:

(a) explain the funding objective, and describe any anticipated benefit increases which have been taken into account;

(b) specify the period involved, and any scheduled changes to that period for future valuations;

(c) state the procedure used to allocate the excess and whether the allocation is based on earnings or service; and

(d) state the Actuarial Cost Method to be used to determine future allocations when the end of the specified period is reached.

Note 2: The funding objective will usually be expressed as the Actuarial Accrued Liability as projected to exist under another Actuarial Cost Method at the end of the specified period.

Note 3: Under this method, Actuarial Gains (Losses), as they occur, reduce (increase) the annual cost allocation.

Note 4: Only a Projection Actuarial Cost Method with an Open Group assumption should be so labeled; if an Open Group assumption is used with any other Actuarial Cost Method, the method should be named and the Open Group assumption described.

Section C

SUPPLEMENTAL GLOSSARY

C-1. Accrued Benefit or Accumulated Plan Benefit

The amount of an individual's benefit (whether or not vested) as of a specified date, determined in accordance with the terms of a pension plan and based on compensation (if applicable) and service to that date.

C-2. Actuarial Assumptions

Assumptions as to the occurrence of future events affecting pension costs, such as: mortality, withdrawal, disablement and retirement; changes in compensation and national pension benefits; rates of investment earnings and asset appreciation or depreciation; procedures used to determine the Actuarial Value of Assets; characteristics of future entrants for Open Group Actuarial Cost Methods; and other relevant items.

C-3. Actuarial Valuation

The determination, as of a valuation date, of the Normal Cost, Actuarial Accrued Liability, Actuarial Value of Assets, and related Actuarial Present Values for a pension plan.

C-4. Actuarially Equivalent

Of equal Actuarial Present Value, determined as of a given date with each value based on the same set of Actuarial Assumptions.

C-5. Amortization Payment

That portion of the pension plan contribution which is designed to pay interest on and to amortize the Unfunded Actuarial Accrued Liability or the Unfunded Frozen Actuarial Accrued Liability.

C-6. One-Year Term Cost

The Actuarial Present Value, as of a valuation date, of all benefits expected to become payable in the future as a result of an event or events expected to occur during a valuation year.

C-7. Open Group/Closed Group

Terms used to distinguish between two classes of Actuarial Cost Methods. Under an Open Group Actuarial Cost Method, Actuarial Present Values associated with expected future entrants are considered; under a Closed Group Actuarial Cost Method, Actuarial Present Values associated with future entrants are not considered.

C-8. Pay-as-You-Go

A method of financing a pension plan under which the contributions to the plan are generally made at about the same time and in about the same amount as benefit payments and expenses becoming due.

C-9. Projected Benefits

Those pension plan benefit amounts which are expected to be paid at various future times under a particular set of Actuarial Assumptions, taking into account such items as the effect of advancement in age and past and anticipated future compensation and service credits. That portion of an individual's Projected Benefit allocated to service to date, determined in accordance with the terms of a pension plan and based on future compensation as projected to retirement, is called the Credited Projected Benefit.

C-10. Terminal Funding

A method of funding a pension plan under which the entire Actuarial Present Value of benefits for each individual is contributed to the plan's fund at the time of withdrawal, retirement or benefit commencement.

Section D

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PRELIMINARY VIEWS
ON
AN ACTUARIAL STANDARD
FOR PENSION DISCLOSURE

INVITATION TO COMMENT

FROM:
THE COMMITTEE ON PENSIONS
OF THE
CONFERENCE OF ACTUARIES IN PUBLIC PRACTICE

MAY 1983

This mailing is being made to all Enrolled Actuaries and all Fellows, Members and Associates of the Conference of Actuaries in Public Practice.

A. INTRODUCTION AND EXPLANATORY COMMENTS

1. Direction and Makeup of the Committee

In late 1981, the Committee on Pensions of the Conference of Actuaries in Public Practice was asked to write a White Paper on an actuarial standard for pension disclosure. It was to be a definitive statement of what the actuarial profession thinks is meaningful pension disclosure. Committee members were chosen for their background in large private plans as well as small ones, multiemployer plans as well as public plans. The Committee members are as follows:

James F. A. Biggs
Joseph H. Dittmer
Paul A. Gewirtz (Chairman)
Willard A. Hartman
David L. Hewitt
Robin G. Holloway
Daniel F. McGinn
Robert C. North, Jr.
Michael J. Tierney
John P. Wiskowski

2. Why the Committee Was Established

Many actuaries feel that the setting of a standard for pension disclosure by the actuarial profession has been deferred too long. They feel that this has limited our profession's ability to respond more forcefully to those who would make radical and confining changes in pension accounting rules when more adequate and meaningful pension disclosure might well have satisfied the perceived needs. In its response to the FASB, the actuarial profession has strongly advocated additional disclosure in lieu of accounting changes--but, when asked for a definitive standard, the profession has had none to show.

While the lack of a disclosure standard for dealing with this particular problem was certainly a major reason for this assignment, it wasn't the only reason, by any means. A profession must, at some point in its development, codify the guiding principles that are commonly accepted practice in that profession. Our profession has been doing this in a number of areas for some time now. Many feel that a White Paper describing an actuarial standard for pension disclosure is an essential part of this process.

3. Why an Invitation to Comment at This Time

The Committee has met on numerous occasions to define the objectives of pension disclosure, to outline the scope of the eventual White Paper, to decide on meaningful elements of disclosure that would be neither too much for some nor too little for others, and to debate the usefulness of the final product. While we have not yet completed the White Paper, we have made sufficient progress to let you know the direction we took and to reveal the sample disclosure package we developed.

At this point, we need feedback from each of you. If there is enough support for our general direction, then we will...

- publicize the disclosure package to possible users (FASB, etc.) to dissipate pressure for major accounting changes; and,
- use your comments to "fine tune" the present package and proceed with the White Paper.

B. USEFULNESS OF THE DISCLOSURE PACKAGE

The Committee views the eventual White Paper on an Actuarial Standard for Pension Disclosure as defining a standard by which to measure disclosure content that is sufficient to enable sophisticated users to understand the financial implications of a pension plan.

For the most part, actuarial reports contain much, if not all, of the disclosure information already. The additional items can usually be found in existing valuation output or are readily obtainable. We don't think there will be a significant burden for medium-sized and larger plans to supply the recommended information, and we do not propose that this standard be applied to smaller plans.

The Committee is *not* recommending that pension actuaries adopt this format to replace or even standardize their own reports. We fully expect that actuaries will continue to design their reports to fit different needs and circumstances. Instead, we propose that the Summary Disclosure Statement serve as a *summary* of the actuary's reports, available to the user *by request* through the client (much like various auditor's questionnaires are now handled).

The Summary Disclosure Statement will have standardized content *and* format. We believe that this standardized approach to disclosure--which is really all we are suggesting--will improve comparability between plans *without* requiring major changes in pension accounting. After all, this is the message our profession has given to the FASB, and this approach provides a structure to implement it.

If there is enough support, we intend to publicize our disclosure standard to various user groups who have urged better disclosure in the past. If *they* see a value in it as a way of satisfying their demands for comparability and other such objectives, they may wish to adopt this standard for their future information requests from plan sponsors. It is our hope, of course, that the pressure for major pension accounting changes will be dissipated through the availability of more effective disclosure.

C. OBJECTIVES OF AN ACTUARIAL STANDARD FOR PENSION DISCLOSURE

Perhaps the biggest problem in setting an adequate actuarial standard for pension disclosure is that of information overload. What is barely sufficient information to a sophisticated analyst is incredibly confusing to the average plan participant.

The Committee decided to solve this problem by recommending a standard disclosure package consisting of a Summary Disclosure Statement, which selectively and concisely displays some key information for the convenience of the user, and a Building Blocks Exhibit containing the elemental "building blocks" of disclosure, from which the interested user can derive a great variety of additional information. While the Building Blocks Exhibit would be identical for all occasions, the Summary Disclosure Statement could be varied for the audience.

The Committee decided to use a two-part disclosure package after failing to find a single Summary Disclosure Statement which would satisfy most user requirements--and be brief as well. Rather than suggest a compromised standard which might prove unsatisfactory to some users, the Committee decided that a package which always contained the elemental building blocks would generally satisfy the more demanding users--if they were advised on the proper use, interpretation and limitations of various indices and ratios that might be derived. This would be provided for in the White Paper. When you review the Disclosure Package in Section E, please keep in mind that the explanatory material in the White Paper, not just the numbers, will be available to a user on request.

The final disclosure package should be appropriate even for users with modest needs--because the Summary Disclosure Statement would be simple and the Building Blocks Exhibit could be ignored by the user, if so desired. However, it was the needs of the more demanding users (such as auditors or financial analysts) that prompted our decision. Their needs can be summarized as follows:

- -- They are fundamentally interested in information that assists their estimates of future corporate cash flow and viability. The form of that information, i.e., whether it is reported in the balance sheet or in footnotes, is of less importance.
- -- They would like information that is consistent or standardized among companies and industries; or, if it is not consistent, they would like enough information so that they can make their own adjustments.
- -- More specifically, they want:
  - The actuarial present value of the employer's total pension obligation, as well as the actuarial present value of accumulated plan benefits with and without a salary scale.
  - Key economic, investment, and actuarial assumptions being used for the pension plan.
  - A measure of pension expense as an aggregate percentage of payroll. While recognizing that various methods for measuring pension expense are viable, many analysts would like to see some narrowing in permitted alternatives.
  - A comparison of actual plan experience with the actuarial assumptions that were made.

While it is not our intention to suggest standard disclosure which satisfies primarily the more demanding users, neither can we ignore their special needs. Hence, the need for the Building Blocks Exhibit as part of the standard package.

D. OUTLINE OF THE EVENTUAL WHITE PAPER ON AN ACTUARIAL STANDARD FOR PENSION DISCLOSURE

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E. DISCLOSURE PACKAGE

1. SUMMARY DISCLOSURE STATEMENT
THE ABC COMPANY DEFINED-BENEFIT PENSION PLAN

I. INTRODUCTION

I-A. Date and Basis of Valuation

The valuation was performed as of January 1, 1982, the first day of the Plan Year and the company's fiscal year. The valuation was based on the Plan provisions and benefit levels in effect on January 1, 1982, employee data compiled by the company as of January 1, 1982, and on a "going concern" concept. The actuarial value of assets was determined based on information provided by the Trustee as of January 1, 1982.

I-B. Benefit Synopsis

Benefit equals 2% of final average 5-year salary times years of benefit service, less 50% of Primary Social Security benefit. Unreduced benefits start at age 62. Accrued benefits become fully vested after 10 years of credited service. Death and disability benefits are also provided.

II. FUNDING AND EXPENSING

II-A. Funding and Expense Summary
(Amounts in 1,000's and as % of Pay)

	1/1/82	1/1/81	1/1/80	1/1/79
ERISA Funding Limits				
- Regular Minimum	$64.0 (5.2%)	$58.0 (5.3%)	$54.0 (5.1%)	$48.0 (5.0%)
- FSA Balance	10.0CR(.8%)	7.0CR(.6%)	6.0CR(.6%)	3.0CR(.3%)
- ERISA Minimum	54.0 (4.4%)	51.0 (4.7%)	48.0 (4.5%)	45.0 (4.7%)
- ERISA Maximum	74.0 (6.0%)	68.0 (6.3%)	64.0 (6.0%)	58.0 (6.0%)
- Method	Entry Age	Entry Age	Entry Age	Entry Age
Contribution Paid	$66.0 (5.3%)	$60.0 (5.5%)	$56.0 (5.3%)	$48.0 (5.0%)
- Method	Aggregate	Aggregate	Aggregate	Entry Age
Pension Expense	$42.0 (3.4%)	$38.0 (3.5%)	$54.0 (5.1%)	$48.0 (5.0%)
- Method	Unit Credit	Unit Credit	Entry Age	Entry Age

Values based on provisions, methods and assumptions in effect as of date shown.

II-B. Expense Policy

Pension expense is computed by the use of the projected Unit Credit actuarial cost method, 7% interest, 6% salary scale, and "going concern" type decrements, including retirement decrements under which the average age at retirement is expected to be age 62. The actuarial value of assets is based on market value. For 1982, the pension expense equaled the normal cost ($22,000) plus an amortization payment ($20,000) which will amortize the unfunded actuarial accrued liability under the Unit Credit Method over 18.10 years.

11-C. Contribution Policy

It is the company's general policy to contribute an amount determined under the Aggregate Actuarial Cost Method with 7% interest, 6% salary scale, and "going concern" type decrements, including retirement decrements under which the average age at retirement is expected to be age 62. The actuarial value of assets is based on market value. Payment is usually made on the date the tax return is due (including extensions). The company is free to vary the amount and date of contribution above or below the pension expense amount, subject to ERISA minimum and maximum limits.

II-D. Changes in Basis Since Previous Year

- Plan Amendments--ad hoc increases for prior retirees.
- Actuarial Assumptions--The interest rate was changed from 6% to 7%. In addition, the salary increase assumption was changed from 5% to 6% per annum.
- No changes in actuarial cost methods were made for the current valuation.

II-E. Actuarial Gain (Loss)

The actuarial gain for the year ending 1981 was $150,000. Most of this gain was attributable to investment earnings in excess of what was assumed for valuation purposes. The remainder of the gain was due to a combination of all other experience factors, including salary increases and employee terminations in excess of what was assumed for valuation purposes.

11-F. Special Events

The actuarial valuation takes into account the 1981 sale of the XYZ subsidiary. Plan assets equal to the actuarial present value of accrued benefits were paid to the successor corporation. This transaction resulted in a $50,000 actuarial gain to the Plan during 1981.

II-G. Aggregate Funding Index Trend

In order to provide an overall measure of the trend in the Plan's funding requirements, an Aggregate Funding Index has been established and is provided below:

	1982	1981	1980	1979
Aggregate Funding Index	5.3%	5.5%	5.3%	5.0%

The Aggregate Funding Index is equal to: the actuarial present value of projected benefits minus the actuarial value of assets, divided by the actuarial present value of projected future valuation payroll.

The increases in the Aggregate Funding Index in 1980 and 1981 were caused primarily by ad hoc improvements for prior retirees.

III. FUNDED STATUS

III-A Funded Status Summary
(in 1,000's)

		1/1/82	1/1/81	1/1/80	1/1/79
a)	APV of Accumulated Plan Benefits	$1,423	$1,206	$1,023	$ 933
b)	Funded Status Assets	1,424	1,194	963	709
c)	— Funded Ratio (b÷a)	100%	99.1%	94.1%	76.0%
d)	APV of Credited Projected Benefits	4,001	3,697	3,206	3,069
e)	Funded Status Assets	1,424	1,194	963	709
f)	— Funded Ratio (e÷d)	35.6%	32.3%	30.0%	23.1%

- APV means Actuarial Present Value.
- Accumulated Plan Benefits are benefits earned to date.
- Credited Projected Benefits are benefits based on credited service to date, but using expected future salary at retirement.
- Funded Status Assets means (Specify basis of asset measurement here.)
- Values based on provisions and actuarial assumptions in effect as of date shown.

III-B. Basis for Funded Status Summary

The actuarial present value of Accumulated Plan Benefits is based on 7% interest and "going concern" type decrements, including retirement decrements under which the average age at retirement is expected to be age 62. The actuarial present value of Credited Projected Benefits is based on 7% interest in combination with a 6% salary scale and other decrements as described above.

III-C. Changes in Funded Status Basis Since Previous Year

The interest rate was increased from 6% to 7% per annum for both calculation bases, while the salary scale was changed from 5% to 6% per annum.

III-D. Special Events

The funded status measurement takes into account the 1981 sales of the XYZ subsidiary. Plan assets equal to the actuarial present value of accrued benefits were paid to the successor corporation.

IV. DEMOGRAPHIC TREND

Active and retired Plan participants are summarized below:

Actives	1982	1981	1980	1979
#	163	159	154	150
Average Age	34	33	33	32
Average Service	14	13	12	12
Average Annual Pay	$12,102	$11,692	$10,947	$10,263
Retireds				
#	24	17	13	6
Average Age	67	66	65	64
Average Annual Benefit	$ 840	$ 809	$ 520	$ 502

In addition, the Plan had 2 disabled employees receiving benefits totalling $6,200 per year, and 11 vested terminated employees entitled to future benefits.

V. CONTINGENT OBLIGATIONS

No recognition was given to benefit increases which will become effective on October 1, 1983. Also, the actuarial values that would apply in the event that the "going concern" concept becomes inapplicable in the future would differ from those shown above. Plan provisions may be different in the event of plan termination, merger, spinoff, and the actuarial assumptions used in the above calculations may not be applicable under these events. In the event of a plan termination, the excess of the actuarial present value of PBGC insured benefits over the market value of assets becomes a liability of the company (up to 30% of net worth). Because of procedural complexities, estimates of the contingent liability may be wide of the mark. However, we estimate there was currently no contingent PBGC liability under this plan as of the valuation date.

VI. OPINION

In preparing this statement, we have relied on the information provided by the Company regarding plan provisions, plan participants, plan assets, and other materials. The actuarial present values shown have been estimated on the basis of actuarial assumptions which, in the opinion of the undersigned, are appropriate for the purposes of this statement, are reasonable in the aggregate (taking into account the experience of the Plan and reasonable expectations), and, when applied in combination, represent a reasonable estimate of the anticipated experience under the Plan.

(NAME OF FIRM)

By:______________________________
(Name of Actuary and Professional Designations)

2. BUILDING BLOCKS EXHIBIT
(One for Each Year)

A. Valuation Date and Period Over Which Items are Applicable

B. Participant Summary*

	Active	Receiving Benefits	Inactive w/Deferred Benefits
1) Count			
2) Payroll (or benefit amount)			
3) APV of Future Pay (or person years)		XX	XX

C. Actuarial Assumption and Actuarial Cost Method Summary*

D. Benefit Summary*

E. Summary of Valuation Results	For Funding	For Expensing
1) Actuarial Cost Method		
2) APV of Projected Benefits		
3) APV of future Normal Costs		
4) Actuarial Accrued Liability (AAL)		
a) Change in (AAL) due to:		
i) Method		
ii) Assumption		
iii) Benefits		
b) Actuarial Gain (Loss)		
i) Asset Source		
ii) Liability Source(s) (combined)		
iii) Non-Current Reserve Source	XXXX	
5) Asset balances:		
a) Actuarial value of assets		
b) Market value of assets		
6) UAAL		
7) Non-Current Reserve (Balance Sheet Liability)	XXXXX	
8) UPAAL (Unprovided actuarial accrued liability)	XXXX	
9) Normal Cost		
10) Amortization		
11) Interest on Non-Current Reserves	XXXXX	
12) Accrued Interest		

F.

Contribution and Expense Items	Amount	% of Pay, or $ Per Participant)	Actuarial Cost Method Used
1) Regular Minimum			
2) FSA Balance			
3) ERISA Minimum			
4) ERISA Maximum			
5) Contribution Paid			
6) Booked Expense			

G. Funded Status Summary:

	APV of	
Categories	Accumulated Plan Benefits	Credited Projected Benefits
1) Vested participants		
a) Currently Receiving Benefits		
b) Entitled to deferred future benefits		
2) Non-vested participants		
3) Total		

4) Funded-Status assets: $________________

*More complete summaries of these items will be attached as appendices.

ASSEMBLY OF GOVERNMENTAL EMPLOYEES,
Washington, D.C., November 23, 1983.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Washington, D.C.

DEAR MR. SALMON: The Assembly of Governmental Employees [AGE] is a federation of public employee organizations throughout the United States. For over 30 years, AGE has viewed with great concern the preemption of state authority by the federal government. We are especially concerned with the possible introduction of the Public Employees Pension Plan Reporting and Accountability Act [PEPPRA] discussed during the hearing in the House Education and Labor Subcommittee on Labor-Management Relations and the House Ways and Means Subcommittee on Oversight, November 15, 1983.

As public employees, our members are keenly aware of the importance of a sound retirement system. Recognizing the need for reform in certain areas, AGE affiliates have supported and will continue to support pension reform efforts to insure the dollars will be available upon retirement. AGE supports and encourages state and local efforts to protect the rights of public employees who rightfully expect the retirement system to remain sound. Many jurisdictions have undertaken such reform and indeed have made great progress to improve many aspects of their plans. The public employees most directly affected by public pension plans are critically aware of this need to protect their hard-earned retirement benefits. With this desire in mind, many have elected representatives to their retirement board and/or work through their state associations to safeguard their pension dollars.

It is our belief that such reform should be based on need as well as instigated on the state and local level. AGE strongly opposes the preemption of state authority over public pension systems by this legislation. It is our belief state government is the appropriate level to deal with their pension system. With this thought in mind, AGE delegates attending the 1983 General Assembly in Baltimore, Maryland unanimously passed the following resolutions:

Whereas, retirement systems are best administered by the jurisdictions whose employees are covered by the systems; and

Whereas, control of and policy affecting a retirement system is more appropriately and effectively determined by those administering the systems; now therefore be it

Resolved, that AGE policy include the position of opposing and encouraging its affiliates to oppose any legislation designed to impose federal control of public employee retirement systems.

AGE affiliate organizations understand and recognize the need for safeguards and will continue to work for those safeguards on a state and local level. As a representatives of public employees whose future security is at issue, we share in our affiliates concern, however, we strongly oppose federal preemption on this issue.

We would appreciate your inserting our letter as part of the official record.

Sincerely,

LAURA M. WILLIAMS, *President.*

STATEMENT OF THE NATIONAL ASSOCIATION OF COUNTIES [1]

The National Association of Counties is pleased to present for the record testimony to the House Subcommittee on Oversight on certain issues regarding public employees pension benefit plans. Your attention to these issues is very timely and will provide for a better understanding of the growth, scope and financial status of State and local governmental plans, and whether additional Federal disclosure, reporting or fiduciary standards for such plans are appropriate.

NACo has studied the issue of public pension reform and in particular several bills (H.R. 4928 and H.R. 4929, the Public Employee Pension Reporting and Accountability Act), which were designed to establish additional local government administrative and enforcement procedures aimed at more reporting, disclosure and fiduciary responsibility requirements. Upon consideration of such legislative initiatives, the National Association of Counties reaffirms its opposition to any PEPPRA legislation.

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[1] NACo is the only national organization representing county government in America. Its membership includes urban, suburban and rural counties joined together for the common purpose of strengthening county government to meet the needs of all Americans. By virtue of a county's membership, all its elected and appointed officials become participants in an organization dedicated to the following goals: improving county government; serving as the national spokesman for county government; acting as a liaison between the nation's counties and other levels of government; and achieving public understanding of the role of counties in the federal system.

We recognize that there have been and still are some problems with the structures, funding situations, and reporting and disclosure policies of some State and local government pension programs. We believe that State and local government officials recognize these problems, have shown that they can reform their own systems, and will strengthen these reform measures in the coming years. We do not believe that the solution is for the Federal Government to create a new Federal bureaucracy to determine, regulate and enforce uniform reporting, disclosure, fiduciary and administrative standards for public pension plans.

Neither the decided trend toward increased legislation and oversight at the State level nor any proposed PEPPRA legislation has changed enough to warrant any modification of our policy toward Federal regulation of State and local government pension plans. We strongly believe that the State governments are in the best and most appropriate position to legislate, regulate and enforce State and local government pension policies. The National Association of Counties supports and encourages improvements in reporting, disclosure and fiduciary standards at the State government level.

With increasing responsibility for the provision of Government services being shifted to the States, counties and cities through block grants, New Federalism initiatives and Federal deregulation, it strikes us as very odd that these levels of Government have been deemed capable in this regard, and yet would be judged incapable of regulating and administering their own basic pension systems by Congress. On the one hand we are being told that local government should assume full responsibility for such diverse and major societal needs as welfare, food stamps, education, transportation and social services, at the same time, that those local governments are not equipped to handle a basic employer function—pensions.

BACKGROUND

State and local governments should retain the basic responsibility to structure, maintain, and reform their own pension plans. We believe that all parties involved should encourage and work toward basic principles for their own programs such as full disclosure, reasonable reporting, sound funding, strong fiduciary standards, prudent investment practices, plan consolidation where possible, increased portability, and better integration with social security and other related systems. However, the ultimate decisions in these and other public pension areas for their own plans must be made by the State and local government elected officials themselves according to their judgment of the unique realities, limitations, needs, and requirements of their governments and in a fair and equitable manner vis-a-vis their employees and the taxpayers.

We believe the Federal Government role in the public pensions vis-a-vis State and local governments should be one of encouragement for reform, a provider of technical assistance, leader in operating reasonable plans for its own employees, and a catalyst in the development of voluntary guidelines for use by State and local governments in reshaping their pension programs.

We believe we should and can manage our employee pension plans without direct Federal involvement, public pensions being a basic, integral function of State and local governments. We do not believe it is necessary for the Federal Government to "save" State and local officials from themselves in the area of pensions.

Given the decided trend toward internal improvement and reform at the State and local government level and the general Federal policy of returning more authority and responsibility for Government services and programs to State and local governments, it is neither appropriate nor wise to enact new Federal authority and increased Federal regulation of this basic State and local government function.

NACO POLICY

The National Association of Counties has a long-standing policy encouraging pension reform at the State and local level. In addition, our organization has held numerous training sessions, workshops and policy discussions on pension reform. NACo policy as embodied in the American county platform is that public pension plans represent an increasingly significant factor in the management of county governments. NACo supports full disclosure and reasonable reporting of information regarding public pension plans, strong fiduciary standards, prudent investment practices, sound funding, and equitable vesting requirements.

Public pension plans, their funding, benefit levels, and their management represent a series of complicated policy choices arrived at by elected public officials. The decisions not only involved fiscal considerations, but labor-management decisions as well. Public pension plans are an integral function of county, municipal, and State Governments. NACo opposes Federal interference with this important function because Federal regulation threatens the ability of local elected officials to carry out mandates given to them through the electoral process. The National Association of Counties also supports the notion that in the orderly discharge of their responsibilities, State and local governments should observe the following principles:

Provide for realistic and equitable levels for retirement, survivors, and disability benefits.

Appropriate and timely reporting of the pension system's financial conditions to plan participants, elected officials, taxpayers, and other interested parties.

Establishment of a financing plan to assure adequate funding of future benefit obligations as they are earned and accrued and to amortize accrued unfunded liabilities.

MAJOR ISSUES

We submit the following facts and conditions which we believe argue overwhelmingly against Commissionthe need for and desirability of Federal PEPPRA legislation:

1. State and local government pensions are part of the basic and integral personnel and compensation functions of those levels of Government and thus should be regulated by those levels of Government.
2. Over ninety percent of State and local government employees are covered by pension programs and the vast majority of these are members of large or statewide pension systems which are generally well administered and funded.
3. State legislatures have taken giant strides in the past few years to set up pension committees and task forces and to reform and consolidate pension systems in their States.
4. A major impetus for ERISA legislation, private sector bankruptcies and defaults, simply does not exist in the public sector. To date, there have been no defaults on State and local pension obligations of which we are aware.
5. State governments, not the Federal Government, have the ultimate responsibility for pension obligations of their public plans and those of their jurisdictions. Therefore, they are the most appropriate level of Government to regulate State and local government pensions.
6. Each State has diverse and unique conditions and retirement systems which warrant flexibility and control at the State Government level rather than one uniform set of national standards.
7. Even limited Federal PEPPRA legislation would, over time, result in increasingly strict, pervasive and inflexible regulations and Federal bureaucratic policies.
8. In addition to State legislation and oversight, there are "free market" forces such as bond rating reviews and accounting standard certifications which effectively reinforce sound funding and good administration.
9. We fear that Federal regulation of State and local government pensions would inevitably be influenced by ERISA provisions and principles which would blur the real differences between public and private pension programs and their administration.
10. The proposed legislation would add a plethora of new regulations, requirements and paperwork mandates which would increase the costs, burdens and complexity of pension administration for State and local governments.
11. Any proposed legislation may be unconstitutional based on the *National League of Cities* v. *Usery* Supreme Court Decision. Such legislation clearly violates the spirit of that decision.
12. There is no compelling national interest or national crisis which warrants Federal intervention in the State and local government oversight, regulation and administration of their pension plans.

THE FEDERAL ROLE

We suggest that the Federal role in the area of public pensions should be to assist and encourage State and local governments in better structuring and managing their own pension programs. We believe that role could best and most constructively be accomplished by the establishment of some voluntary guidelines to be used by State and local governments in reviewing and reforming their own pension plans.

The method used in the workers' compensation area is a possible approach to such an endeavor.

Whatever method or forum is used should involve state and local government officials and should embody an advisory philosophy in reaching a national consensus on the basic principles of sound public pension plan structure and administration. Even within this context, any recommendations must be voluntary and recognize the diverse requirements, structures and needs of State and local governments and their pension systems.

The approach embodied in past legislative attempts has in our judgment, been the wrong way to affect reform in State and local government pension plans. We believe it would create more problems than it solves and miss the mark as to the real problems of some plans, penalize the majority of plans which are well administered, and overstep Federal intergovernmental relationship authority. Additionally, we believe that other attempts to legislate pension reform would have only served to:

1. Override existing State constitutional protections for members and annuitants.
2. Increase the cost of administering retirement systems, and divert funds which could otherwise be used for benefit increases.
3. Open confidential individual accounts to public disclosure.

THE STATE AND LOCAL GOVERNMENT EXPERIENCE

State and local government officials have shown increasing awareness of and willingness to deal with problems in their pension systems. Much progress has been made in the past few years to reform and revise public pension programs. Indeed, it is very much in the best interest of public officials to assure that their pension programs are well administered and soundly financed. Very few State and local government employees are now covered by "pay as you go" pension plans, whereas most Federal Government employees are covered by such plans. State and local governments have the increased incentive of bond rating companies, which increasingly scrutinize pension benefits and funding in determining their ratings.

Another trend in public pensions is the non-contributory pension program. Public employers are increasingly paying the full share of their employees' pension benefits. It is difficult to argue that public employees are being treated unfairly in this respect.

Full reporting and disclosure by plan administrators has become the rule without Federal Government requirement. These procedures may not always meet full ERISA requirements, but there has been a dramatic improvement in recent years. It is unrealistic and unnecessary for diverse systems in different States to comply with one national standard which is designed for another sector of the work place altogether.

In the funding area, it is particularly inappropriate to measure public plans by ERISA standards because State and local governments do not go out of business. Even pension experts do not agree on one model, percentage or number of years of amortization which should be required in the public sector. We can probably all agree that "pay a you go" systems like those in the Federal sector are not desirable. However, complete funding of benefits which is required in private sector is probably too conservative for many public plans because it ties up too much of current taxpayers' funds for future benefits.

The major issues of public pension plans—level and structure of benefits, basis for funding, probability of benefits, and social investments—should not be addressed in any legislation. These issues should be decided by the State and local governments themselves through their appropriate processes. What has been provided for in past congressional initiatives are a potentially complex set of regulations which would interfere with State and local government decision-making, blur the real distinctions between public and private plans, cost the taxpayers and State and local governments considerable expense, and standardize reporting, disclosure and fiduciary procedures based on Federal Government bureaucratic decisions.

We do not argue with specific provisions of any previous bill on their own merits. In fact, most of the provisions make good sense in their own context. We disagree with the fundamental approach that the Federal Government should regulate, oversee and preempt State and local government decisions in this fundamental area. We are frankly very concerned about creeping Federal Government expansion of authority and regulation should a PEPPRA bill become law. Based on years of previous experience in a variety of Federal programs, we do not believe that Federal rulemakers will limit themselves to the letter of the law nor be able to keep the ERISA and PEPPRA requirements completely separate.

While we appreciate some of the revisions which included many of the previous versions of PEPPRA, we can not support any future versions for the reasons outlined above. Much progress has been made in State and local pension plans over the past few years, and more will follow. Additionally, we believe that States should continue to have the primary authority to legislate and regulate, and that local governments should have the obligation to administer and fund their programs soundly. The Federal Government should act as an example of how to fund and operate model programs for their own employees and provide assistance and encouragement to State and local governments for reforming their programs.

STATEMENT OF DAVID L. KEATING, EXECUTIVE VICE PRESIDENT, NATIONAL TAXPAYERS UNION

The National Taxpayers Union, representing 120,000 members in all 50 states, commends the Subcommittees for holding joint hearings on state and local public employee pension plans.

Today there are over 6,000 state and local government public employee retirement systems. Many state and local governments now rely heavily on federal grant funds and revenue sharing to help meet pension costs. In this context, it should be apparent that the federal taxpayer has a considerable interest and stake in who's going to pay for state and local government pension benefits, outlays and actuarial deficits.

Of particular interest to taxpayers are requirements for disclosure of the financial status and benefits of public employee pension plans. We supported the disclosure and reporting requirements contained in the proposed Public Employee Pension Plan Reporting and Accountability Act of 1982 (H.R. 4928 and H.R. 4929, 96th Congress).

The General Accounting Office (GAO) conducted a study, "Funding of State and Local Government Pension Systems: A National Problem," in August of 1979. The study reviewed 72 of the major pension plans and found that these plans alone had accumulated unfunded actuarial liabilities of approximately $29 billion. The GAO also pointed out that about 56 percent of the plans were not being actuarially funded. In a 1980 analysis of these plans, the GAO found that 53 of the 72 plans could not meet the funding standards imposed by the Employee Retirement Income Security Act of 1974 on private pension plans.

Many public employee retirement systems have serious problems. State and local governments that already have excellent funding and disclosure standards have nothing to fear from disclosure requirements. Only the plans that are poorly funded, poorly run, and a poor deal for taxpayers or beneficiaries have anything to worry about.

We agree with Professor Roy Schotland of Georegtown University Law School who testified before the Subcommittee on Savings, Pension and Investment Policy of the Senate Finance Committee on March 29, 1982 and said:

(1) Effective disclosure activates local political processes, so that pension problems are more likely to be worked out at home.

(2) Disclosure cannot be effective unless local taxpayers and pension participants can compare how their funds are doing, relative to other similar funds.

(3) Only the federal government can assure comparability of information about pension plans.

(4) Required disclosure is that least intrusive and least costly form of regulation. This makes it especially appropriate when, as here, the federal government must take some steps affecting state and local government in order to protect the federal taxpayers' vulnerability as pension insurer of last resort.

Legislation requiring adequate disclosure of state and local public employee pension plans is long overdue. It's time that the poorly run pension plans and their unfunded liabilities receive the visibility they deserve.

OREGON PUBLIC EMPLOYES RETIREMENT SYSTEM,
Portland, Oreg., November 16, 1983.

CHARLES B. RANGEL,
Chairman, Ways and Means, Subcommittee on Oversight, Longworth House Office Building Washington D.C.

DEAR REPRESENTATIVE RANGEL: It is our desire that this statement in opposition to the reintroduction of the Public Employee Pension Plan Reporting and Accountability Act be included in the printed record of related hearings.

Enclosed is the National Council on Teacher Retirement Resolution, with which we concur, in strong opposition to enactment of any Public Plan Reporting Act. It sets forth the continuing stance of our membership in resisting the tampering with the present adequately controlled funding status of public sector trusts.

As very succinctly stated in the correspondence from many other public trusts, the majority of public funds, as Oregon's, is excellently funded, has never been vulnerable to manipulation and in no instance have employes been threatened with loss of benefits.

Oregon's system covers over 150,000 state and political subdivisions, general service employes, teachers and police and fire personnel actuarily evalued and examined, on an average of every three years. It is a joint contributory trust with its retired reserves fully funded and its minimal active life unfunded liability (less than 10 percent) amortized statutorily over a 30-year actuarial period. It was created by the Oregon legislature in 1946, and never has been subject to termination at the participant's expense. There are over 700 contributing public entities who monthly forward required contributions to maintain the stability of its operation. Its actuarially sound, joint contributory portfolio of over four billion dollars has, through our last annual audit December, 1982, (for five years ending), returned a compounded 15.6 percent on equity (35 percent of fund) and over 11 percent on fixed income. It has outperformed the S&P in almost every marked period.

Our legislature, our political subdivisions and our courts have rallied in their continuing support of the public employes' pension interests and rights. The single formula benefit is based on unisex factors and is a fair and equal benefit trust.

We maintain a well-diversified equity, fixed income investment portfolio with the advice and assistance of 14 money managers and six consultants. The statutory "reasonable prudent person rule" is our singular and optimum guideline.

As our NCTR executive secretary's Texas colleagues so well stated ". . . state and local government plans are already subject to oversight by employe organizations, the media, state legislatures (school boards) and executive agencies. Federal regulation will not improve upon and may, in fact, impair pension services, security and benefits provided under existing state laws. . . ."

We seek your strong leadership in opposition to the Public Employee Pension Plan Reporting and Accountability Act concept.

Sincerely,

James L. McGoffin, *Director.*

Enclosure: The NCTR Resolution appears elsewhere.

The Public School Retirement System of Missouri,
November 23, 1983.

Mr. John J. Salomon,
Chief Counsel, Committee on Ways and Means, Longworth House Office Building, Washington, D.C.

Dear Mr. Salomon: The Board of Trustees of The Public School Retirement System of Missouri, which is responsible for the administration of retirement systems covering more than 80,000 active public school employees and 20,000 benefit recipients, wishes to present this statement concerning federal regulation of public retirement systems.

The Board is aware of the recent joint hearings by the Subcommittee on Oversight and the Subcommittee on Labor-Management Relations in this area, and that legislation which would establish federal regulation of public retirement systems will likely be introduced early next year. It is the belief of the Board of Trustees that most of the concerns voiced by proponents of so-called PEPPRA legislation either are non-existent or grossly exaggerated, and that most public systems covering the vast majority of state and local workers presently meet or exceed proposed PEPPRA requirements. In that vein, we wish to set forth some of the safeguards and protections afforded to members of Missouri school retirement plans, as follows:

1. Our systems are created by and operate under Missouri statutes. Those statutes require the Board of Trustees to be bonded and to serve under oath without compensation, and forbid any investment transaction by any firm in which any board member has an interest.

2. Chapter 610, Revised Statutes of Missouri, popularly known as the "sunshine law," requires open meetings and open records by all public bodies in this state. Hence, all meetings of the Board and records of its proceedings are open to the public.

3. Chapter 105, Revised Statutes of Missouri, establishes conflict-of-interest prohibitions for all public boards and commissions within the state.

4. The retirement law requires the Board of Trustees to formulate and adopt rules and regulations for administration of the retirement systems. Board regulations provide a process for appeal by individual members or employers included within the systems.

5. The Missouri general assembly has established, by law, a standing committee to monitor the operations of all public pension and retirement plans in the state. The committee, named the "Joint Committee on Public Employee Retirement", is a bipartisan body made up of members from both houses of the general assembly.

6. The law requires the Board of Trustees to establish individual member accounts, and to issue annual financial and actuarial reports. It further requires an annual review by an actuary, and guarantees that the cost of benefits cannot exceed the resources necessary to pay the benefits.

7. The Missouri state auditor is required, by law, to audit the retirement systems at least every two years. In addition, the Board requires annual audits by private auditors.

8. The law expressly prohibits any commingling of retirement funds with state funds; the retirement systems are, by law, corporate bodies separate and apart from any branch of state government. Any funds deposited with a financial institution must be secured by appropriate collateral. The law limits the types of securities for investment of retirement system funds to specific instruments and categories.

9. The Board publishes a handbook for the members explaining the retirement programs, which is updated as the law changes or the benefits are improved. A newsletter, dealing with retirement matters or legislation of topical interest, is published and mailed on a quarterly basis. An individual account statement is sent to members each year showing service, financial, beneficiary, and other data. The Board publishes an annual financial statement, and makes public annual reports of the actuary and the auditors. The staff schedules regular regional informational meetings, accepts all requests for meetings with member groups, and works closely with educational associations and retired teacher associations in the dissemination of information.

In summary, we believe the Missouri school retirement programs adequately meet the needs and concerns which some have said should be addressed at the federal level. We fail to see how federal laws or regulation could improve upon the situation; rather, we think such regulation would represent unnecessary intrusion by the federal government into matters better left to the states, matters which in fact are now properly addressed by the states. We hope the Committee, and the Congress, will give these thoughts serious consideration if, and when, PEPPRA legislation is introduced in the future.

If there should be additional information this office could furnish to the Committee, we should be glad to do so.

Yours very truly,

DAVID W. MUSTOE, *Executive Secretary.*

PUBLIC SCHOOL TEACHERS' PENSION AND RETIREMENT FUND OF CHICAGO

BOARD RESOLUTION REGARDING PERISA

Whereas, Congress is considering PERISA legislation, to include HR 6525 or similar legislation, which would create a federal agency called the Employee Benefit Administration to regulate public and private pension systems, and

Whereas, the new Employee Benefit Administration agency would have the authority to create and enforce regulations regarding public pension programs, and

Whereas, PERISA legislation would require additional actuarial reports to be performed and informational reports to be submitted to the Employee Benefit Administration which would incur considerable additional and unnecessary cost to public retirement systems, and

Whereas, passage of PERISA legislation would in effect transfer jurisdiction of public employee retirement systems to the federal government, now, therefore, be it

Resolved, that the Board of Trustees of the Public School Teachers' Pension and Retirement Fund of Chicago is strongly opposed to HR 6525 and other PERISA legislation, and

Be it further resolved, that The Board of Trustees of the Public School Teachers' Pension and Retirement Fund of Chicago does hereby express its strong opinion that state, county, and municipal retirement systems are and should remain the jurisdiction of existing state and local units;

Be it further resolved, that a copy of this resolution be provided to President Ronald Reagan, members of Congress, the National Conference of State Legislatures, the National Council on Teacher Retirement, the National Conference of Public Employee Retirement Systems, and other parties at interest in this important national issue.

STATE OF TENNESSEE, TREASURY DEPARTMENT,
CONSOLIDATED RETIREMENT SYSTEM,
Nashville, Tenn., November 23, 1983.

Mr. JOHN J. SALOMON,
Chief Counsel, Committee on Ways and Means, Longworth House Office Building, Washington, D.C.

DEAR MR. SALOMON: We are writing to make known for the record our concern about proposed federal legislation which is designed to regulate retirement plans of state and local employees.

We are proud of the current status of the Tennessee Consolidated Retirement System and vigorously oppose federal interference with our plan.

The T.C.R.S. covers all state employees in Tennessee—the Governor, judges, legislators, attorneys, highway employees, university employees, etc.; all public school teachers; and local government employees if the local government chooses to offer our plan. We are qualified under Internal Revenue Code Section 401(a).

We are governed by state law. Our plan may be changed by legislative action; however, the courts in Tennessee have adopted the "Pennsylvania Rule" and, therefore, member's benefits cannot be detrimentally affected once a member has vested. (See *Blackwell* v. *Quarterly Court of Shelby Co.,* 622 S.W. 2d 535 (Tenn. 1981).

The retirement plan is found in T.C.A., Title 8, Chapters 34 through 37. Our plan is a defined benefit plan managed by a Board of Trustees composed of state officials and elected employee representatives. All funds of the retirement system are managed "in house" by state employees. Investment policy is recommended by an Investment Advisory Council, composed of experts from private industry. The policy is then approved by the Board of Trustees.

Permissible investments are determined by the same provisions which govern domestic life insurance companies (T.C.A. 56-3-303, 304). In addition, state law prescribes fiduciary standards for all trustees (T.C.A. 37-301 et seq.) which apply to responsible individuals in the T.C.R.S.

The assets of the retirement system are valued for actuarial purposes on a current basis—equities are valued on a five-year moving market average and bonds are shown at their amortized book value.

By law, the State Treasurer must file an annual financial disclosure statement with the Secretary of State (T.C.A. 8-50-501 et seq.). In addition, the Board of Trustees' Investment Policy requires all portfolio managers and stock and bond traders to file disclosure statements on the same basis.

As mentioned previously, the provisions governing the T.C.R.S. are entirely statutory. In 1971, the legislature enacted a statute creating a joint legislative committee which was responsible for overseeing all pension legislation. This committee is composed of senators and representatives who also serve on the finance ways and means committees in the legislature. This committee reviews all pension legislation and the fiscal impact of each bill. The committee is reluctant to approve bills which are costly. They recognize a strong responsibility to fund the pension plan as it currently exists.

Tennessee has adopted a forty year plan for funding retirement costs and we are in the eighth year of that process. Pension plan contributions have never been used as a tool for balancing the state budget.

All records of the retirement system are open for public inspection pursuant to state law (T.C.A. 10-7-503).

The retirement system is subject to the provisions of the State Uniform Administrative Procedures Act (T.C.A. 4-5-101) which permits parties which are aggrieved by a decision which we make to appeal that decision at an administrative level to the Board of Trustees.

We feel that our retirement system had made tremendous strides in the past ten years.

We recognize a responsibility to our members, our retirees, participating employers and the taxpayers. We are enclosing some examples of publications which have been distributed to our members.

We feel that regulation of pension plans for state and local employees should be a state function for legal reasons and policy reasons. Tennessee has acted responsibly in administering our plan and our state laws provide adequate protection for plan members.

We are attaching a copy of a letter sent to the Tennessee Congressional Delegation last July which further explains our concerns with the proposed legislation.

Thank you for this opportunity to communicate our thoughts on this important issue.

Sincerely,

STEVE ADAMS, *Director, TCRS.*

Attachments.

SENATE CHAMBER,
STATE OF TENNESSEE,
Nashville, Tenn., July 16, 1982.

Hon. BILL BONER,
Cannon House Office Building,
Washington, D.C.

DEAR CONGRESSMAN BONER: We are writing to call your attention to two pieces of legislation which are currently pending before Congress and to urge that you vote to defeat these.

Both pieces of legislation are known as the Public Employee Pension Plan Reporting and Accountability Act of 1982 or PEPPRA. H.R. 4929 is being sponsored by Representative Phillip Burton and H.R. 4928 is being sponsored by Representative Erlenborn. Both are being sponsored by Senator John Chafee in the Senate.

Our objection to this legislation is twofold. First of all, we concur in the policy statement by the National Conference of State Legislators which opposes this bill as an unwarranted interference by the Federal government in the area of state pensions. We have attached a copy of their statement for your review. Tennessee has been very active in the pension area and has a joint legislative council which reviews all pension legislation prior to its passage. In addition, every amendment to the state pension law must include funding for its provisions. Tennessee has been on a program to amortize the cost for pensions over a 40-year period and we are now in the seventh year of that program. We feel that we have acted responsibly and prudently in providing equitable pensions for the employees of the state of Tennessee as well as avoiding windfalls to various employee groups at the expense of the taxpayer. We are proud of the course which Tennessee has followed in the pension area and will be happy to sit down with you at anytime to review the current status of our plan. We would respectfully suggest that the state of Tennessee has dealt responsibly and prudently with its pension programs and its experience and track record far exceed and overshadow the unfortunate position of that of the federal government in this area.

We feel that there are constitutional problems involved with the federal government regulating the area of state and local pensions. We especially call your attention to the Supreme Court case of the *National League of Cities* vs. *Usery,* 96 S. Ct. 2465 (1976) which prohibited application of the federal minimum wage and maximum hour provisions to employees of states and local governments.

Our second objection to the PEPPRA legislation concerns the bill itself. We have estimated that the cost of complying with the provisions of this bill in Tennessee would be in excess of $200,000 a year. On its face, the bill requires the reporting of information to plan participants in the form of a summary plan description as well as an annual financial report. We currently provide both items to plan participants. In addition, this bill imposes fiduciary responsibilities on trustees and imposes the "prudent man rule". Again, this is currently the law in Tennessee and our fiduciaries have been expected to meet or exceed this standard. Part of the cost which we foresee in complying with PEPPRA is due to the requirement that our records be audited by an independent qualified public accountant prior to preparation of our annual report. Currently, our records are audited by the State Comptroller's office in addition to being open to all members of the plan. Cost to the system will also result from the information which is required to be included in the annual report identifying the name and social security number and estimated benefit of all plan participants who have terminated from the plan. This information is not currently compiled nor is it published in any state document but is available upon request. The cost of complying with this requirement as weighed against the benefit is unnecessarily high. The PEPPRA legislation subjects the retirement plan maintained in Tennessee for Tennessee state employees to the jurisdiction of federal courts. In addition, it makes it subject to federal regulation. As we stated earlier, prior to the passage of any legislation in Tennessee a fiscal note is prepared so that we can accurately estimate the potential cost of this legislation on an annual basis and over a 20-year period. Such a requirement would not be necessary in the federal regulatory atmosphere and, therefore, regulations could be imposed on our plan which would substantially increase the cost to taxpayers in Tennessee without any direct input by the taxpayers or their representatives.

Again, we urge you to vote against this legislation. It is our understanding that support for this legislation has come from a number of employee groups which we feel are probably not familiar with the possibly adverse impact that this legislation may have on their retirement benefits. Funds which must go toward meeting federal regulatory requirements must come from some source. The more money that is spent on filing paperwork with Washington, the less money that can be spent for pensions for the employees of Tennessee.

It is our understanding that one of these bills will come to a vote soon on the floor and we urge you to carefully consider state employees and the citizens of Tennessee prior to your vote.

Thank you for your careful consideration of this issue.

Yours very truly,

LEONARD C. DUNAVANT,
Chairman, Council on Pensions and Retirement.

STATEMENT OF BETTY PYLE, PRESIDENT, TEXAS CLASSROOM TEACHERS ASSOCIATION

I am Betty Pyle, State President of the Texas Classroom Teachers Association. Accompanying me is Tommy Duck, our Executive Director. The Texas Classroom Teachers Association is a professional organization representing approximately 25,000 members who are employed as classroom teachers throughout the state of Texas. We appreciate the opportunity to present our association's views as they relate the regulation of public employees' pension benefit plans. We commend the work of these two subcommittees in reviewing alternatives before the Congress on key public retirement issues.

The Texas Classroom Teachers Association is on record as opposing any federal legislation that would endanger the integrity and/or stability of the Teacher Retirement System of Texas. In our opinion, PEPPRA legislation, such as that which was proposed during the last session, may create more problems than it solves. Although such legislation was undoubtedly well-intentioned, in our opinion the proposals we have seen have serious flaws which could potentially cost retirees benefits, burden plans with excessive paperwork, and violate the individual's right to privacy. We are also concerned that the PEPPRA legislation as it has previously been proposed is an unwarranted intrusion of federal regulation in an area which should properly be reserved to the states.

Many states have already taken substantial steps to assure well managed state and local government pension systems. For example, Texas has a State Pension Review Board which examines and reports on the funding of all public plans (other than federal) within the state. Texas laws also require information concerning their plans to be regularly and individually provided to public employees. The major state and municipal plans in Texas are well-operated, actuarially sound, and efficiently managed.

The conditions which justified federal regulation of private pensions (ERISA) do not exist in the public sector. The assets and administration of public pension plans are subject to much more intense public scrutiny than most private plans. State laws and courts have historically responded to protect the pension interests and rights of public employees. In our opinion there is no compelling need for the enactment of legislation to provide for federal regulation of public pension plans. We are aware of no situation in which a state or local employment pension benefit has been lost because of inadequate funding. Public pension systems are ongoing institutions not subject to sudden termination at the participants' expense. It is imperative that if Congress plans to interject the federal government into the process of administering public pensions and retirement plans, it must do so with only the most careful deliberation and consideration.

Another concern of our association is the ultimate cost of such federal regulation to the consumer. Will such legislation impose burdensome procedures and costs on state and local governments, thereby reducing the benefits payable to the plan participants? Increased paperwork, regulatory control over the type of investments a plan may make, and the possibility that rules could permit broadened investment policies which might be detrimental to the interests of public pension plan participants, all contribute to our belief that federal regulation could actually diminish, rather than increase, protection for our members.

Proponents of last session's version of PEPPRA have stated that Texas will be "automatically exempted" from the Act. This assertion does not, however, seem totally accurate for several reasons. First, the exemption contained in the bill proposed last session would apply primarily to the disclosure and reporting sections of the Act, and not to the provisions which would preempt the Texas constitutional protection for public retirement funds. Secondly, since the detailed reporting and disclosure requirements would be established later by the Secretary of Labor, there is no way to know now whether Texas would in fact be exempt, even though our disclosure practices are generally superior to those proposed last session. Thirdly, if the bill requires disclosures of personal information on plan participants, Texas would not be exempt. Our state laws currently make this type of information confidential, but federal legislation could supersede the privacy now available to Texas participants in public pension plans.

We understand and appreciate the position of some proponents of federal regulation of public pension plans that, in times of financial need at the state govenment level, political leaders sometimes attempt to solve budget problems by reducing state contributions to public employee pension plans. This potential problem should, however, be resolved at the state level and not be the imposition of federally mandated minimum standards.

In conclusion, the Texas Classroom Teachers Association strongly opposes any efforts by the Congress of the United States in establishing a set of regulatory standards to govern existing state and local pension plans. We maintain that public and private pension plans are inherently different and should not be regulated or administered in the same manner. Given the importance of this issue to our nation's public employees and the massive amounts of money involved in the various public pension plans across the country, we urge you to carefully consider whether there is truly a need for such legislation and what its impact might be on the public sector employees.

Thank you again for the opportunity for the Texas Classroom Teachers Association to express its views. We would be glad to answer any questions you may have.

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